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Boosting Productivity and Growth: A Franco-German Agenda for Europe

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The challenge facing Europe and primarily Germany and France is how to become more productive and innovative while not giving up on any of its hallmarks: (i) democracy and freedom; (ii) the social model; (iii) the commitment to fight climate change. France and Germany, by joining efforts and starting a coalition of the willing, may be able to initiate the necessary momentum to unlock the growth potential of the two countries and of the European Union as a whole. This policy note highlights eight key areas where France and Germany should take the lead with initiatives:

1. Strengthening European innovation instruments, starting with a Franco-German (D)ARPA
2. Accelerating Europe's AI infrastructure, starting with a Franco-German AI-Gigafactory, and promoting the diffusion of AI
3. Democratizing access to innovation careers, starting with a Franco-German "democratizing innovation" fund and joint initiatives
4. Creating a true single European market, including the "28th regime"
5. Creating an adequate financial ecosystem for breakthrough innovation
6. Translating research into business models
7. Digitizing administrative process and reducing reporting requirements and compliance burdens
8. Reforming tax and transfer systems to support economic growth

This policy paper is one of a series of five short action-oriented policy memos that have been prepared to inform the Franco-German Council of Ministers on 29 August 2025 at the request of the French and German leaders, by independent economists of both countries, under the auspices of the Franco-German Council of Economic Experts (FGCEE). The memos were coordinated by Xavier Jaravel, (LSE, Co-Chair FGCEE), Jean Pisani-Ferry (Bruegel, Co-Initiator), Monika Schnitzer (LMU Munich, Co-Chair FGCEE) and Jakob von Weizsäcker (Saarland, Co-Initiator)

After a catching-up period post-WWII, during which European GDP per capita partly caught up with US GDP per capita, the gap has widened again since the 1990s. For the last twenty years, Europe has been experiencing a relative productivity decline vis-à-vis the US and recently also vis-à-vis China. On the positive side, Europe is an uncontested world leader when it comes to: (i) democracy and freedom; (ii) the social model; (iii) the commitment to fight climate change. The challenge facing Europe and primarily Germany and France is how to become more productive and innovative while not giving up on any of those three hallmarks.

Human capital remains strong, with excellent universities and frontier research capacity. European households alone save approximately €1.4 trillion annually, providing a massive internal capital pool that needs to be better mobilized. Europe is projected to hold the largest share of the global green-technology and sustainability market by 2025, propelled by its ambitious Green Deal, EU-ETS framework, investment funding, and its innovation ecosystem for renewables.

Yet much of this potential remains under-used due to Europe's fragmented markets and persistent national silos. Talented entrepreneurs and high-skill workers frequently leave the continent in search of better financing conditions and higher wages – often relocating to the United States. At the same time, approximately €300 billion of European savings are invested abroad each year, notably in U.S. assets, due to more attractive returns and deeper capital markets. Moreover, while European scientists generate a substantial share of the world's frontier research, this knowledge is not sufficiently translated into commercial innovation by European firms – highlighting a gap between research excellence and industrial application (Bergeaud, 2024).

The Draghi report (2024) has outlined a number of paths forward, and the European Commission has begun implementing several of its recommendations. It is essential to speed up the implementation of these recommendations. In cases where it seems difficult to get all EU members on board in a short time horizon, **France and Germany, by joining efforts and starting a coalition of the willing, may be able to initiate the necessary momentum to unlock the growth potential of the two countries and of the European Union as a whole**.

This policy note highlights **eight key areas** where France and Germany should take the lead with initiatives, some of which can be implemented very quickly, some of which take more time but where it is therefore even more urgent to get them started as soon as possible. There seems to be a general understanding of the need of structural reforms in general, while a political consensus on specific measures seems more difficult. At the same time, there are other margins of reforms that are politically less controversial, but where there seems to be too little sense of the urgency of the actions needed, in the face of a rapidly changing technological landscape. In the following, we start by pointing to concrete policy proposals on how to foster innovation and new business models and conclude with recommendations for a selection of structural reforms.

We first identify **three areas where France and Germany, by joining forces, can implement instruments that can serve as role model for reforms at the European level**.

1. Strengthening European innovation instruments, starting with a Franco-German (D)ARPA

Europe needs new, ambitious initiatives to support frontier innovation at scale and to compete globally in critical technologies. This means moving beyond incremental reforms. **To foster break-through innovation in key areas such as energy transition, defense and AI, and health, France and Germany should create joint equivalents of the American ARPA** (Advanced Research Projects Agency). ARPA was founded in the US in 1958. It was renamed DARPA (Defense Advanced Research Projects Agency) in 1972, when its focus was complemented by defense-related technological breakthroughs. The recent Bocconi report showed that Europe is still lacking such institutions. These new European ARPAs might be joined subsequently by other EU countries plus the UK, though on a voluntary basis. We firmly defend a „coalition of the willing" approach, and the UK could be involved from the start given their strengths in the above-mentioned areas.

Germany's SPRIND – the Federal Agency for Disruptive Innovation – is a positive example of a flexible, bottom-up innovation instrument, and recent evaluations have confirmed its effectiveness. However, with a budget of only around €220 million in 2024, SPRIND operates on a fraction of the scale of DARPA's roughly $4.37 billion annual funding – even though DARPA focuses mostly on defence R&D. This contrast underscores the urgent need for a European-scale effort that matches global competitors in ambition and resources.

In the military innovation space, Europe's instruments remain limited. Germany's Cyberagentur has a small budget and narrow remit, and France's AID, despite its larger budget, lacks the freedoms and flexibility of SPRIND or DARPA. A Franco-German (D)ARPA – with funding that matches the scale of DARPA adjusted for the relative size of the economies, operational freedoms modelled on SPRIND, and a mandate covering high-risk bets in strategically vital areas from AI to semiconductors to

defence — is necessary to provide the coordination and scale Europe needs to remain a global technology leader. A truly effective innovation strategy will require pooling resources and accepting asymmetric short-term benefits, in service of long-term collective gains. Achieving such consensus among all European states may be difficult in the short run – but **France and Germany can lead the way, by setting up a Franco-German (D)ARPA, setting ambitious joint targets, and demonstrating that strategic technological leadership is possible when coordination and cooperation replaces competition.**

For such an initiative to be effective on the European level, **these efforts must be embedded in a broader strategy of coordination between national research systems**, with a focus on building critical mass and avoiding fragmentation. This includes better alignment of priorities, shared infrastructures, and interoperable funding tools. Joint public procurement mechanisms, modeled on successful collaborative frameworks, and selective EU-level borrowing should be mobilized to support strategic investments. These tools are particularly well-suited to technologies with high fixed costs and long-time horizons. But this approach demands a shift in political mindsets: European cooperation must no longer be conditioned by a logic of national returns alone.

To foster innovation and growth it is key for European countries including France and Germany to make efforts to retain European talent and to attract talent from outside Europe. France, Germany and the EU as a whole should also take advantage of the havoc that the new US government causes in the US academic system and seize the opportunity to pro-actively invite US-based scientists to pursue their scientific research plans in Europe. A joint Franco-German programme, like the Meitner-Einstein-Programme that was proposed by a group of German Academics, would improve the chances of succeeding with offers that are made to US-based academics.

Formal rules for immigration of skilled individuals from non-EU countries are liberal (Blue Card), but Europe is not attractive enough. Restrictions regarding the recognition of professional qualifications should be lowered and temporary tax incentives for very high skilled immigrants could attract more foreign talent (Poutvaara, 2025). Reducing red tape and facilitating innovation and entrepreneurial activity would contribute to retaining talent.

2. Accelerating Europe's AI infrastructure, starting with a Franco-German AI-Gigafactory, and promoting the diffusion of AI

The EU's InvestAI initiative aims to mobilize up to €200 billion for AI, including €20 billion for four gigafactories with around 100,000 advanced chips each (European Commission, 2025a). While this is a step forward, it remains far below the scale of the U.S., where Microsoft alone plans to invest about $120 billion in AI infrastructure over the next two years, or China, which is expanding capacity at a similar pace. As of May 2025, the United States holds about three-quarters of global AI supercomputer capacity, while China is in second place with 15%. Germany and France now play marginal roles in the AI supercomputing landscape. This shift largely reflects the increased dominance of major technology companies, which are predominantly based in the United States.[1] Without further investment, the gap will continue to widen. Europe must therefore go beyond InvestAI.

Building the capacity to both develop advanced AI models and deploy them at scale across industry and public services will require massive infrastructure. Streamlined approval procedures and a rapid expansion of the energy grid are essential if Europe is to meet the enormous power needs of future data centres.

Because of the high fixed costs and limited resources involved, no single European country can reach the necessary scale alone. **A joint Franco-German initiative would be the most effective way to build additional AI gigafactories and close the gap with global competitors. Such an effort could also provide a template for wider European cooperation**. A shared Franco-German AI Gigafactory would echo the Airbus project of the late twentieth century, proving that ambitious collaboration can deliver global industrial leadership.

To make this vision concrete, France and Germany should commit to building an AI Compute Campus by 2027 with more than 100,000 GPUs or equivalent technologies, fully powered by renewable energy. Setting up a Franco-German joint project over and above the EU InvestAI initiative would notably increase the chance to speed up the process of building sizable compute resources, which, given that time is of utmost essence, would be a major advantage. Joint public procurement could be used to secure the necessary GPUs and cloud infrastructure,

[1] Epoch.ai : "The US hosts the majority of GPU cluster performance, followed by China".

following the model of collective vaccine purchases during the COVID crisis.

These facilities will however only be credible if they are protected by a dedicated **AI Security effort**, built to the highest standards and able to resist cyberattacks. Hostile state actors are already trying to steal advanced models, which makes this an urgent priority. **A joint Franco-German AI Security Institute could be launched first to tackle the most pressing issues and to prepare the ground for a future European-level institute**.

Innovation must develop alongside security. Companies, from established industrial groups to small startups, should have reliable access to computing power, opportunities to test new ideas in real-world conditions under flexible regulatory frameworks, and stronger funding options that bring in more private capital. France and Germany have the right foundations. Their diverse industrial base can turn AI-driven intelligence into concrete products and manufacturing improvements. Their firms also hold vast amounts of industrial data that could be used to create specialized and efficient AI models, particularly in sectors where energy use is high.

Both countries also have a strong pipeline of talent. Their universities produce some of the best AI researchers in the world, yet many still choose to leave for the United States. Keeping them in Europe will require more attractive opportunities at home, fewer bureaucratic obstacles for academic spin-offs, and investment in ambitious research programs that match the scale of those abroad. International partnerships will also matter. Closer cooperation with democratic mid-sized powers such as the United Kingdom and Canada would strengthen Europe's position and help build a credible third hub for AI, alongside the United States and China.

In addition, we need to accelerate the diffusion of AI to foster growth and employment (see Aghion, Bunel and Jaravel 2025 for a review of empirical studies on this point). The transformative potential of AI is not limited to frontier firms: diffusion to SMEs and traditional sectors is essential to raise aggregate productivity. The UK provides a useful model with dedicated initiatives such as:

– "Catapult UK" centers to support SME adoption of AI

– "Skills bootcamps" to reskill workers in AI-related technologies

France and Germany should develop similar programs, combining financial incentives, technical support, and workforce training.

3. Democratizing access to innovation careers, starting with a Franco-German "democratizing innovation" fund and joint initiatives

Broader participation in innovation is essential for long-term growth and social inclusion. Today, opportunities to become an inventor, entrepreneur, or scientist are heavily skewed by parental income, gender, and geography. For instance, a model developed by Einiö et al. (2023) finds that gender parity in access to innovation careers could raise productivity growth by up to 70% - i.e. **going from 1% to 1.7% annual TFP growth per year. Recognizing the macroeconomic potential of democratizing innovation is essential. Importantly, this approach can both increase economic growth and reduce inequality**.

The composition of the innovator pool also shapes what gets innovated: personal experiences guide entrepreneurial focus and determine who benefits from innovation.

Several evidence-based policies can help close the opportunity gap:

– Early exposure to innovation careers, including mentorship and role model programs (Bell et al., 2019; Breda et al., 2023)

– Dedicated funding streams to support underrepresented groups in innovation

– Targeted education and outreach programs in disadvantaged areas

These initiatives are cost-effective levers to unlock talent and accelerate growth. A first step in this area would be to set up a **Franco-German democratizing innovation** fund that would be used to fund initiatives with the potential to democratize innovation, starting with mentorship and role model initiatives with leading French and German scientists and innovators.

To promote inventor-pupil mentorship, a **Franco-German matching platform** could be created, pairing pupils (esp. girls and low-income) with inventors/engineers by field; this platform could also be used for paid summer internship placements at innovative firms or in research labs. This approach would help strengthen the ties between the science and innovation ecosystems in France and Germany, acting as an "Erasmus program for science and innovation."

As a starting point in the short run, an **intensive program focusing on 200 paired schools** (100 in France, 100 in Germany) could be launched. Each participating class would receive 40 hours per year of structured exposure

– lab and company visits, inventor talks, and mini-projects tied to real-world challenges (hydrogen, batteries, medtech) – and would be twinned with a counterpart class across the border (FR<–>DE), with exchanges supported by logistics and grants from the Franco-German Youth Office. This program could then be scaled up over time.

Finally, France and Germany could organize a j**oint annual Franco-German Innovation Prize** on green industrial problems (e.g., battery recycling, heat-pump install tech, circularity), targeting high-school and university students. Winners would receive a stipend and financial support to explore the idea further. The competition would help raise awareness in high school and university about innovation careers.

We next identify **two areas where coordinated French and German action is essential to accelerate reforms at the European level**:

4. Creating a true single European market, including the "28th regime"

European markets remain too fragmented. Yet market size is crucial for fostering innovation, investment, and competition (Aghion and Howitt 1992, Acemoglu and Linn 2004, Jaravel 2019). In order to remain attractive for future-oriented growth firms that are pursuing disruptive technologies, **Europe needs to offer a large, harmonized market**, in which new products can be tested.

While creating a common (single) market is part of the mission of the European Union, this potential remains unrealized. A recent IMF analysis (IMF, 2024) finds that in 2020, trade costs within Europe were equivalent to sizable tariffs. For goods in the manufacturing sector, the indirect costs amount to the equivalent of 44 percent, for services even to 110 percent (IMF, 2024). These frictions represent instances of national regulation, national supervision and bureaucracy that hamper the single market. Well-known examples include the A1 certificate (Portable Document A1) required when sending employees temporarily to another EU country. Other examples come from the construction industry where firms are required to submit building plans and the control of building materials to often extensive national re-certification, even if already EU compliant. Frequently these efforts are hampered by national industries lobbying against their removal (to benefit from implicit protectionism). As a result, Europe is not able to compete on the global market and will continue to lose global market share in trade and GDP.

France and Germany should lead the charges in fully eliminating these frictions across industries. If France and Germany remove trade barriers and generate a large Franco-German marketplace, they will significantly increase their attractiveness as a location for innovative growth firms. Other European countries will be encouraged to join and benefit from their access to the joint market.

Such efforts will also help the EU Commission to move further in their Single Market Strategy. **The EU Commission has recently presented their "Terrrible Ten" of top barriers to be removed**. Some are concrete goals (in the labeling realm), others are still abstract harmonization goals. **A joint Franco-German initiative will help prioritizing and specifying concrete and implementable steps**. The removal of trade frictions and barriers at high speed is what the current moment calls for more than ever.

The same arguments apply to the financing of growth and innovation. **Europe urgently needs a harmonized, deep capital market to provide funding to providers of new technologies in the scale up phase**. In order to increase the volume of venture capital funding, Europe needs to remove barriers in cross-border capital flows and simply the establishment of large growth funds. One promising step is to support a voluntary EU-wide corporate charter and insolvency regime – two key examples of the so-called "28th regime." This regime would allow companies operating cross-border to opt into a unified legal and regulatory framework, slashing compliance costs and legal complexity. In doing so, it would create the foundation for the European firm: a company that operates seamlessly across member states, with legal certainty and a focus on scaling innovation and growth. It would also create the basis for attracting financial investments into growth companies, which can scale up within Europe. The initiative is currently in the consultation phase, with adoption of the legal proposal envisaged for Q1 2026 (European Commission, 2025b). However, as has been the case repeatedly in the past, there continues to be a risk that the introduction of the 28th regime could be blocked or significantly delayed by national interests. A joint Franco-German position and initiative would set standards and help accelerate European alignment thus increasing the chances of timely adoption.

France and Germany could help speed up that process by quickly setting up a **unified legal and regulatory framework for French and German high-growth startups, which could serve as a blueprint for the 28th regime**.

5. Creating an adequate financial ecosystem for breakthrough innovation

A key reason for the prolonged periods of low or no growth in France, Germany, and many other EU member states is the lack of scale-up opportunities for innovative firms developing new technologies. The dominance of traditional industrial sectors, which drove Europe's post-war growth, is unlikely to return. For firms with growth potential, the US and Asia remain more attractive, especially during the scale-up phase, largely because financing conditions are more favorable.

Europe is not short of savings, but it lacks the deep and dynamic financial ecosystem found in the US. Venture capital is more limited, institutional investors are less engaged in financing innovation, banks do not rely as heavily on securitization to extend lending, and Europe still lacks the equivalent of NASDAQ or fully integrated capital markets.

A well-functioning Capital Markets Union is therefore essential to channel private capital into innovation and growth. Current fragmentation, including the lack of a harmonized insolvency law, restricts access to finance for SMEs and start-ups. Without harmonization of the insolvency regime, investors have to evaluate identical assets differently if located in different European countries. This affects not only expected returns from a given asset, say a windfarm or a gigafactory, across countries, but also the correlation with different macroeconomic developments, significantly complicating the set-up of funds for similar assets across European countries.

Vice versa, it is important not to focus capital-market harmonization efforts on measures like "strengthening securitization." While it might be a desired outcome for the European banking market, it will not provide for genuine progress in building deeper capital markets: such steps may support banks but do little to expand capital-market-based funding. Only the latter has the potential of significantly fostering growth and innovation.

One idea would be the creation of a pan-European secondary market for pre-IPO technology firms. This would allow early investors and employees to sell shares before a public listing, increasing liquidity and reducing the risk of being locked in for years. By improving exit options, such a market could in principle make investment in European start-ups and scale-ups more attractive, drawing in more private capital and giving founders better access to funding without having to turn abroad.

Secondary markets do not create value on their own; they work only if there is already a steady pipeline of firms and enough institutional investors willing to buy in. If combined with a functioning Capital Markets Union and changes in investor behavior, such a platform could provide meaningful additional liquidity for European scale-ups.

France and Germany together should also emulate the Swedish example, and favor the emergence of new institutional investors. Institutions such as large pension funds are key to realizing deeper capital markets and, in particular, providing funding to innovative, future-oriented (but risky) young firms. They are core participants in growth funds, which are urgently needed to encourage scale-up of young companies, but undersupplied or non-existent in many European member states.

These Franco-German priorities should be embedded within a broader **European productivity agenda**, addressing complementary levers such as enhanced competition in product and service markets, and improved labor reallocation mechanisms. Yet, while EU-level reforms are critical, they will only succeed if paired with bold national reforms. We highlight **three domestic priorities** for France and Germany, which could also be taken up by joint Franco-German initiatives:

6. Translating research into business models

Despite strong research institutions, Europe often lags in commercializing scientific breakthroughs. For example, Europe accounts for 21% of patents in computer and digital technologies compared with 55% in the US (Fuest et al., 2024). This pattern holds across many high technologies. The gap is not due to a lack of scientific output: when tracing the origins of patents through patent-to-paper linkages, a significant share of the underlying scientific publications is produced in Europe (Bergeaud, 2024). **France and Germany should take the lead in closing this gap by strengthening the link between scientific research and industrial innovation**. This requires rethinking the incentives and instruments that foster collaboration between public and private sectors. Priority should be given to facilitating the subcontracting of R&D projects to public laboratories, encouraging researchers to engage in entrepreneurship, and supporting knowledge transfer mechanisms. Concrete steps could include a "**Patent-to-Startup**" grant scheme offering non-dilutive funding for firms based on public research, the adoption of standardized IP licensing templates to reduce negotiation time, and mobility grants enabling researchers to spend time in start-ups or SMEs.

Both countries already have experience with programs of this kind – ranging from France's CIFRE doctoral contracts to Germany's Fraunhofer model – and should build on

existing evaluations to design a more effective and scalable system. They could also strengthen career structures that allow academic researchers to take entrepreneurial leave with the option to return, or combine part-time university appointments with work in a spin-off. Such measures would reduce the personal risk of entrepreneurship and make it easier for researchers to test ideas in the market. Ultimately, the aim should be to develop a framework that enables the systematic exploitation of the scientific knowledge produced in European labs, not only at the national level, but across borders.

At the same time, Europe should adapt its excellence-based initiatives to strengthen the link between research and industrial innovation. **The ERC could complement its current focus on individual excellence by creating ERC-backed laboratories**. These labs would provide long-term financing for research teams organized around priority topics rather than individual careers, with a strong emphasis on applied research. By securing stable resources for small, focused teams, they would create continuity and critical mass in areas where Europe must not fall behind. Such labs would also offer a more predictable environment for collaboration with industry, making it easier to transform breakthrough research into concrete technologies.

In parallel, excellence lab initiatives such as France's LabEx or Spain's Severo Ochoa programs have shown that concentrated funding can generate important spillovers to the private sector. Evaluations point to particularly strong effects in disruptive innovation, where academic research often provides the initial knowledge base for transformative technologies (Bergeaud et al., 2025). **The creation of an „ERC for Labs" program to select top research labs and provide them with long-term funding, should be actively pushed by Germany and France**. Scaling these initiatives up—either at the European level or at least through Franco-German cooperation—and associating them with stronger incentives for collaboration with firms would amplify their impact. This could involve clearer requirements for industry partnerships, joint governance structures, or co-financing mechanisms that bring firms directly into the research process. In this way, Europe would both secure long-term excellence in academic research and increase the externalities from frontier science to innovative firms, reinforcing its ability to turn scientific leadership into industrial competitiveness.

7. Digitizing administrative process and reducing reporting requirements and compliance burdens

Economic development in Europe is held back by regulation and bureaucratic compliance burdens, which are excessive both in terms of quantity and quality. While other OECD countries have significantly reduced bureaucracy over the past 15 years, bureaucracy in Germany has stagnated, if not increased. France, for example, initiated a major public administration reform under Nicolas Sarkozy's government in 2006, which significantly reduced bureaucracy costs. There is a lack of quantitative evaluation and feedback, and 'gold plating' by member states often adds to the burden as well as the fragmentation of European markets (Draghi, 2024, chapter 6). Streamlining and digitizing administrative processes and reducing compliance burdens can have a significant impact on growth (Falck et al, 2024).

Reducing red tape inevitably requires a review of regulation and government activities. **Abolishing regulations and scaling back government activities where the benefit is smaller than the cost can make an important contribution**. One widely discussed example is the EU directive on corporate sustainability reporting (CSRD). The ESG reporting requirements have been criticized for imposing a significant cost on companies without achieving much in terms of improvements in environmental or social matters. Another example is the new EU Energy Efficiency Directive. It includes a large number of regulations and bureaucratic rules about how companies should monitor their energy consumption although prices provide companies with significant and efficient incentives to save energy. More importantly, the directive obliges the EU member states to reduce their final energy consumption significantly (Germany is obliged to reduce energy consumption by 22% relative to the level of 2023), without regard to whether energy production is 'green' or not. Implementing this would depress economic growth and destroy one of the opportunities of the green transition, which is to use a lot of renewable energy at times when it is available. Abolishing or scaling back the directive would not just remove this misguided cap on energy consumption but also reduce the compliance burden for companies.

8. Reforming tax and transfer systems to support economic growth

Tax policy in Europe currently faces the challenge that revenue is needed for rising public spending in areas like defense while economic growth is weak and a higher tax burden would dampen economic growth. Policy responses should be **restructuring the tax and transfer systems towards better incentives to supply labour and a shift of the burden from investment and labour income towards consumption and immobile factors like land. Tax reforms should also encourage risk taking, entrepreneurship and innovation, and roll back tax exemptions and credits for special interest groups** (OECD, 2010, Abdel-Kader and De Mooij, 2020).

Reforming the tax system to achieve more economic growth comes with tradeoffs. Reducing the tax burden on labour supply, investment and innovation requires tax cuts, which will in turn lower revenues, in particular before the growth effects kick in. Incentives to work and invest can also be strengthened by reducing the progressivity of the tax system, but that goes along with tradeoffs regarding efficiency and redistribution. If governments want to prioritize higher growth they should cut corporate and income taxes as well as direct taxes and social security contributions. Regarding innovation, a key problem is that loss offset restrictions in corporate income taxation discriminate against risky investments, in particular investments to scale start-up companies. These restrictions need to be lifted. The revenue losses can be limited by restricting reforms to losses incurred in the future.

To some extent, the tax revenue losses that go along with these measures can be financed by increasing indirect taxes, in particular the VAT. VAT revenue can also be raised by crowding back the number of goods and services that are subject to reduced VAT rates. Reduced VAT rates are ineffective as instruments for redistribution. It is equally important to review exemptions and deductions for other taxes. For example, German inheritance taxation offers large exemptions and loopholes for company owners and certain types of real estate. Reducing these exemptions and cutting tax rates would make this tax both more efficient and more equitable. Similar considerations apply to the taxation of income from real estate and stamp duty taxes (Fuest et al, 2021).

Reform recommendations for Germany often include the call for higher local property taxes to finance cuts in other taxes. It is true that taxes on land and real estate are less harmful for growth than corporate taxes or personal income taxes. It is also true that local property taxes in Germany are lower than in many other countries. At the same time it is a particularity of German local public finances that some public services (e.g. waste collection) are financed via fees while they are financed via property taxes in other countries. Therefore international comparisons of property tax revenues may be misleading.

While revenue neutral restructurings of the tax system can bring improvements, the potential for these reforms to spur economic growth is ultimately limited. Significant growth effects through tax reforms will require tax cuts and therefore can be achieved without raising fiscal deficits only if they are complemented by efforts to cut public spending.

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