

PRESS RELEASE

Germany has to invest in the future to overcome its sluggish economic growth

- The German Council of Economic Experts forecasts Germany's gross domestic product to decline by 0.4 percent in 2023 and to grow by 0.7 percent in 2024. The inflation rate is expected to be 6.1 percent this year and 2.6 percent next year.
- The main barriers to growth in the coming years include demographic ageing, low productivity growth, an outdated capital stock, and a low number of young and innovative companies.
- More innovation and investment is needed to improve the potential for growth. This requires more liquid capital markets, a culture of equity investments and more venture capital.
- Employment opportunities and incentives to work should be improved to increase labour market participation and reduce poverty risks.
- Demographic ageing calls for a long-term pension reform that needs to combine a bundle of different measures in order to share the burden of ageing more fairly between and within generations.

Wiesbaden, 08.11.2023 – The energy crisis and lower real incomes continue to have adverse effects on the short-term economic outlook. In the medium term, however, the shrinking workforce, the outdated capital stock and the lack of innovative companies weigh on economic growth in Germany. As a result, medium-term growth prospects are at an all-time low. “To rekindle sluggish growth, Germany must invest in its future. This requires stronger productivity advances through innovations, capital formation and more dynamism in the realm of business start-ups. These can partially compensate for the declining volume of work. At the same time, reforms in the tax-transfer system and the pension system are urgently needed,” says Monika Schnitzer, chair of the German Council of Economic Experts (GCEE). In its current Annual Report, the GCEE discusses how this can be achieved in concrete terms.

The economic recovery of Germany is lagging behind. The economy is still held back by the energy crisis and lower real incomes due to high inflation. To fight inflation, central banks around the world have tightened their monetary policies. The monetary tightening and the sluggish development of the Chinese economy have adversely affected the international trade environment. The higher level of interest rates also suppresses investment and construction activity in Germany. The GCEE therefore expects German gross domestic product (GDP) to shrink by 0.4 percent in 2023. In 2024, private consumption is expected to expand due to rising real incomes. This should lead to a modest rebound in GDP by 0.7 percent. Inflation has dropped by roughly half since the beginning of 2023. However, due to strong price pressures at the beginning of 2023, consumer prices are still expected to increase by an annual average of 6.1 percent. While energy and food inflation will subside significantly, core inflation is likely to remain elevated in the coming year. This is partly due to

the sharp rise in unit labour costs, which is likely to lead to sustained price increases for services. The GCEE therefore forecasts an inflation rate of 2.6 percent for 2024.

Since the beginning of the Covid pandemic, Germany has had the lowest GDP growth in the euro area. “Compared to the cyclical weakness, medium-term growth constraints on potential output are significantly more important,” says council member Veronika Grimm. According to the GCEE's medium-term projection, potential output growth will average 0.4 percent annually until 2028 if existing trends continue. This would be a historic low, driven to a large extent by the shrinking workforce. For potential growth to increase again, investment would have to go up and the decline in the total hours worked would have to slow down. “Stronger incentives to work, an ambitious immigration policy, improved schooling and a strengthening of universities are crucial. At the same time, it is important to allow structural change to take place and to mobilise capital to invest in highly productive firms,” explains Veronika Grimm. Investments in capital goods such as machines, robots and information technology can increase overall productivity, especially when applying new cross-sectional technologies such as artificial intelligence. At the same time, such capital formation can offset the foreseeable shortage of labour.

Well-developed and liquid capital markets are central to overcoming weak growth and to financing the digital and green transformation. They channel capital to highly productive companies and sectors of the economy. Market-based financing strengthens investments in new, riskier technologies as well as in research and development. Startups foster innovation and contribute to overall economic growth. However, there is considerable pent-up demand in Germany and other European countries for financing young companies in the early-growth phase.

“Large institutional investors in Europe should provide more equity and venture capital. The institutional framework in Europe should be improved by means of quantitative investment limits and exit options for venture capitalists,” demands council member Ulrike Malmendier. Additional market-based funding could come from a publicly managed pension fund that would serve as a building block of a funded pillar of the pension scheme. Such a fund would also allow households to participate in the capital market and benefit from attractive and broadly-diversified investment opportunities, thus strengthening the equity culture. “In order to help the broader population to gain access to higher returns from investment funds that are low-risk, we should start with children and teenagers. They should be endowed with a starting capital that is invested in such a fund,” adds Ulrike Malmendier.

While real net incomes in Germany have risen by an average of around 25 percent over the past two decades, the incomes of lower-income groups have virtually stagnated. “The share of the population at risk of poverty has risen. Single parents, the unemployed, children and teenagers, and people born abroad are particularly hard hit,” says council member Achim Truger. “A reform of the system of basic welfare benefits can reduce the risk of poverty and strengthen incentives to work without burdening public budgets.” Benefits should be bundled in the basic income support system, with a lower transfer withdrawal rate than in the current system. A reform of the tax benefits for married couples can strengthen the

incentives to work for lower earners, typically women. Well-developed childcare is central to improving parents' employment opportunities.

Demographic ageing will accelerate significantly in Germany over the next 15 years. This will create growing tensions in the budget of the unfunded statutory pension scheme (GRV). “No single measure suffices to solve the budgetary problems of the GRV in the long run. A combination of different reform options is inevitable,” explains council member Martin Werding. “Such a combination can divide the financial burden of an ageing society more fairly between young and old as well as within the generations.” A core element of the reform would be to link the statutory retirement age to life expectancy at retirement. Another core element should be a new form of additional funded pension plans. Since these reform elements affect only long-term outcomes, additional steps are needed to stabilise the GRV budget in the short to medium term. Strengthening the existing link between annual benefit up-ratings and old-age dependency as well as the introduction of an price up-ratings of benefits after award would be possible measures. These measures could be supplemented by a graduated (“progressive”) pension calculation based on income. Reforms of the pension scheme for civil servants should ensure that expenditures on their pensions are also dampened and that reforms of the GRV are mirrored in this system.

Both in terms of availability and in terms of access to research data Germany continues to lag behind other countries. Data-based analyses allow giving evidence-based policy advice and are essential for decision-making in politics and public administration. In order to improve the provision of research data and strengthen empirical research, it is necessary to pass a research data act that prioritises research while balancing data protection, and to improve the resources of official statistics.

Overcoming sluggish growth – Investing in the future

Challenges, **goals** and **measures** discussed in the GCEE Annual Report 2023/24

Low potential output growth

Strengthen innovation

- Tax incentives for R&D
↳ ITEM 158
- Support AI research, strengthen availability of data and digitalisation
↳ ITEMS 161 F.
- Improve primary and secondary school education and strengthen universities
↳ ITEM 159

Expand aggregate hours worked

- Facilitate the reallocation of labour between companies
↳ ITEM 136
- Substitute missing labour volume with capital
↳ ITEMS 132 FF. AND 163
- Facilitate immigration to the labour market
↳ ITEMS 121, 122 AND 159

Mobilize investment

- Advance administration reform, reduce bureaucracy
↳ ITEMS 168 FF.
- Provide tax incentives for investment
↳ ITEMS 120 AND 172
- Implement reliable framework conditions for efficient decarbonisation
↳ ITEMS 111 FF.
- Expand digital and energy infrastructure
↳ ITEMS 109, 123, 161 AND 173

Fragmentation and low liquidity of capital markets

Strengthen capital market financing for companies

- Mobilize private and public venture capital specifically for the growth phase of start-ups
↳ ITEMS 255 FF.
- Increase equity investments of institutional investors
↳ ITEMS 454 F.
- Eliminate tax disadvantage of equity compared to debt
↳ ITEMS 248 FF.

Increase stock-market participation of households

- Expand supplementary funded pension plans and establish a publicly managed pension fund
↳ ITEM 267
- Systematic and independent financial education in schools and at the workplace
↳ ITEM 265
- Provide starting capital for children and young people for early contact with capital market
↳ ITEM 266

Facilitate cross-border investments

- Expand the competencies of the European Securities and Markets Authority (ESMA)
↳ ITEMS 275 F.
- Establish a framework for a European securitisation market
↳ ITEMS 253 F.
- Simplify taxation of foreign income
↳ ITEM 270

Rising risk of poverty and stagnating lower incomes

Better poverty prevention and employment incentives in basic social security

- Bundle benefits in basic social security
↳ ITEMS 320 FF.
- Strengthen employment incentives through lower transfer withdrawal rate
↳ ITEMS 320 FF.

Improve employment incentives and employment opportunities

- Expand childcare options
↳ ITEMS 345 FF.
- Reform tax benefits of married couples
↳ ITEMS 337 FF.
- Promote further training and health measures
↳ ITEMS 350 FF.

Socially responsible climate and crisis policies

- Set up a system allowing for targeted direct payments in the event of a crisis
↳ ITEM 358
- Introduce flat-rate climate benefit
↳ ITEMS 354 FF.

Growing financing needs of the statutory pension scheme (GRV)

Stabilize the GRV budget in the long-term

- Link retirement age to increasing further life expectancy
↳ ITEMS 403 FF.
- Set up a new form of supplementary funded pensions
↳ ITEMS 449 FF.

Provide short-term relief, ease social hardship

- Adjust the sustainability factor
↳ ITEMS 421 FF.
- Introduce price indexation of pensions after award
↳ ITEMS 425 FF.
- Assess benefits graduated by covered earnings
↳ ITEMS 432 FF.
- Reform options to retire early without deductions for long-time insured
↳ ITEMS 416 FF.

Address structural reforms

- Increase employment
↳ ITEMS 388 FF.
- Reform civil servants' pensions
↳ ITEMS 395 FF.
- Introduce compulsory insurance for the self-employed with a choice between GRV and alternative options
↳ ITEMS 400 FF.

Insufficient national research data infrastructure in Germany

Better conditions for official statistics

- Pass Research Data Act that gives high weight to research when weighing up interests
↳ ITEM 572
- Implement output-oriented statistical legislation
↳ ITEM 553
- Increase staff and financial resources
↳ ITEM 554

Higher data availability and better data access

- Make administrative data usable for research
↳ ITEM 565
- Facilitate links between data sets
↳ ITEMS 568 FF.
- Implement remote access to research data as default
↳ ITEM 576
- Design secure data access
↳ ITEM 573

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.

Further information on the German Council of Economic Experts and its publications are available at <http://www.sachverstaendigenrat-wirtschaft.de/en> or follow us on Twitter [@GCEE_en](https://twitter.com/GCEE_en).

Press contact:

Nadine Winkelhaus
Senior media and public relations officer
Phone: +49 611 75-3110
presse@svr-wirtschaft.de