

Executive summary

Economic growth is robust and wellbeing is high

- *Strong domestic demand and exports are driving growth.*
- *Wages are growing moderately.*
- *Economic growth will slow somewhat, due to capacity constraints.*
- *The current account surplus remains large.*
- *Germans enjoy high living standards.*

Using fiscal policy to address structural challenges lying ahead

- *The strong fiscal position provides room in the near term to fund spending priorities.*

Productivity growth is held back by slow technology diffusion

- *Labour productivity growth in recent years has been subdued.*
- *Entrepreneurship is key to faster technology diffusion and higher productivity among SMEs.*
- *Government ownership in business sector activities holds back reallocation.*
- *Improving competition and boosting investment in digital networks would allow to better harness new technologies.*

Preparing for the future of work with new and changing skills

- *Automation, digital platforms, and other technological changes are altering the nature of work.*
- *Technological change increases the demand for cognitive and non-cognitive skills.*

Policies to improve skills and better skills use boost inclusive growth

- *Impressive progress has been made in reducing the impact of socio-economic background on education outcomes.*
- *Better opportunities for women to develop their careers would boost productivity and reduce poverty risk.*

Transport policy reform can contribute to green growth and boost wellbeing.

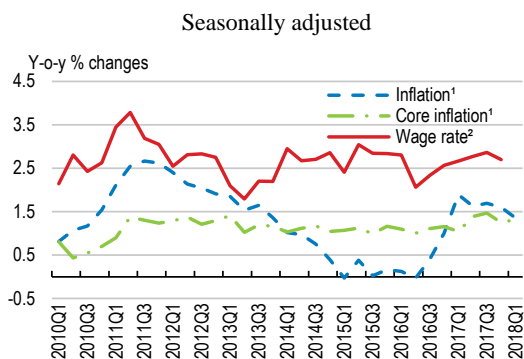
- *Emissions from transport have increased despite substantial gains in efficiency, leaving a weak spot in the overall climate policy mix.*

Economic growth is robust and wellbeing is high

Strong domestic demand and exports are driving growth. Record-low unemployment and real wage gains have underpinned consumption. Low interest rates and immigration boost residential construction. Exports benefit from a goods mix suited to investment needs in high-growth emerging economies and the recovery of the euro area economy. Business investment is picking up with the strong exports. Credit growth remains modest.

Wages are growing moderately. Recent collective bargaining outcomes points to some acceleration in wage growth. Unions have increasingly negotiated non-wage benefits to ensure a better work life balance. However, rising inflation, primarily due to higher oil prices, is eroding real wage gains to some extent (Figure A).

Figure A. Wage growth is moderate



1. Harmonised consumer price index (HICP). Core HICP excludes energy, food, alcohol and tobacco.

2. Average nominal wage per employee.

Source: OECD (2018), *OECD Economic Outlook: Statistics and Projections* (database).

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Economic growth will slow somewhat, due to capacity constraints (Table A). The recovery in the euro area will sustain exports and investment in equipment, while private consumption and housing investment may decelerate somewhat due to slower employment and real wage growth. Consumer price inflation may rise modestly, as

firms can absorb the impact of higher wages in profit margins. The fiscal stance is projected to be somewhat expansionary, as the new government plans tax reductions and higher spending on education, digital infrastructure and social transfers. Nonetheless, strong tax revenue growth and low interest rates are projected to raise the budget surplus to 1.5% of GDP.

Table A. Economic growth will remain robust

	2017	2018	2019
Gross domestic product ¹	2.5	2.1	2.1
Private consumption	2.1	1.0	1.6
Gross fixed capital formation	3.9	3.5	3.9
Exports	5.3	4.5	4.5
Imports	5.6	4.3	5.1
Unemployment rate	3.7	3.4	3.3
Consumer Prices	1.7	1.7	2.0
Core Consumer prices	1.3	1.3	2.0
Current account (% of GDP)	8.1	8.3	7.9
General government fiscal balance	1.3	1.5	1.5

1. Working-day adjusted.

Source: OECD (2018), *OECD Economic Outlook: Statistics and Projections* (database).

The current account surplus remains large.

Saving exceeds investment in the public and private sectors, notably in the corporate sector, where domestic investment has not kept pace with profitability. Exchange rate and energy price movements also mattered. Structural reforms to boost long-term, inclusive green growth and the use of fiscal space to support such reforms could reduce the current account surplus, by strengthening investment and reducing household saving.

Germans enjoy high living standards,

especially in areas like jobs and earnings, and work-life balance. Disposable household income is more equally distributed than in other large OECD economies. However, inequality in wealth and market income is relatively high. Relative poverty risks relate to a high incidence of low-wage employment among low and middle-skilled workers as well as part-time working women.

Using fiscal policy to address structural challenges lying ahead

The strong fiscal position provides room in the near term to fund spending priorities, such as increasing provision of high-quality childcare and full-day schooling, adult skills, or investing in infrastructure and new technologies, as argued below. Fiscal leeway should be used in a prudent manner, taking capacity constraints into account. In the medium term, higher interest rates and ageing-related spending will reduce fiscal space. Additional structural reforms will be needed to maintain sustainability in the long run. Further room for prioritising spending can be identified by more extensive use of spending reviews.

Productivity growth is held back by slow technology diffusion

Labour productivity growth in recent years has been subdued (Figure B), which poses challenges in raising incomes and wellbeing. Slower productivity growth partly reflects strong employment performance, subdued investment, rising skill shortages and slower adoption of new technologies, including in the public sector. Productivity growth has been weaker among small and medium sized firms. Productivity can be boosted by encouraging more firms and individuals to seize opportunities new technologies provide, improving also inclusiveness.

Figure B. Labour productivity growth has slowed down



Source: OECD (2018), *OECD Economic Outlook: Statistics and Projections* (database).

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Entrepreneurship is key to faster technology diffusion and higher productivity among SMEs. Firm creation has been declining partly due to strong employment growth. The lower income security associated with self-employment could hold back entrepreneurship. The period during which failed entrepreneurs must repay debt can last up to six years, discouraging firm creation. Women are under-represented among entrepreneurs, especially in technology-intensive sectors. R&D tax incentives may boost innovation if designed carefully to benefit fully young firms which have not generated profit. Well-developed e-government services can reduce the administrative burdens on start-ups.

Government ownership in business sector activities holds back reallocation of resources and the development of new business models. Privatising government stakes in businesses, including in the *Landesbanken*, could reduce risk of incumbent bias, for example in lending.

Improving competition and boosting investment in digital networks would allow to better harness new technologies. A larger number of mobile communication operators would result in more innovative services at lower prices. The upcoming radio spectrum auction for 5G networks should be used to promote competition in the mobile market. This would also stimulate demand for highest-speed broadband services, boosting roll-out. More investment is needed to expand high-speed broadband in rural areas where unsubsidised provision is unlikely.

Preparing for the future of work with new and changing skills

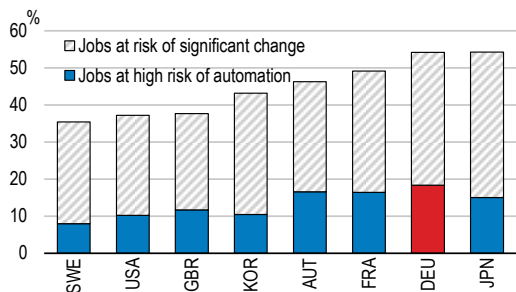
Automation, digital platforms, and other technological changes are altering the nature of work. Jobs with routine tasks are at risk of automation. They are concentrated in middle-skill occupations. The share of jobs with high risk of being automated or of undergoing substantial changes is high (Figure C).

New forms of work, such as digital platforms, involve more workers in flexible arrangements

such as “solo” self-employment. This reinforces the case for extending social safety nets to the self-employed.

Figure C. Many jobs will undergo significant change

The share of jobs at high risk of automation and significant change



Note: Jobs are at high risk of automation if the likelihood of their job being automated is at least 70%. Jobs are at risk of significant change if the likelihood is between 50 and 70%. Source: Nedelkoska, L. and G. Quintini (2018), "Automation, skills use and training", *OECD Social, Employment and Migration Working Papers*, No. 202, OECD Publishing, Paris.

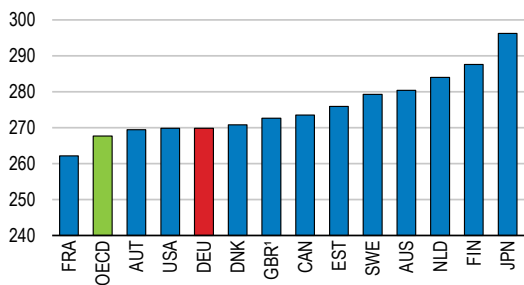
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Technological change increases the demand for cognitive and non-cognitive skills.

Cognitive and digital skills of German adults are above the OECD average, but fall short of leading countries (Figure D). The vocational education and training system ensures excellent integration of young people in the labour market (Figure E).

Figure D. Adult skills are above OECD average

Mean proficiency scores in literacy, 15-65 year-olds



1. Data refer to England.

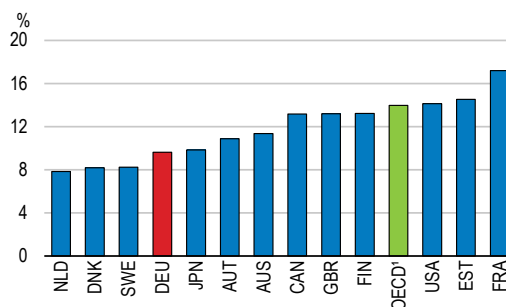
Source: OECD (2016), *Skills Matter: Further Results from the Survey of Adult Skills*.

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More than a quarter of vocational graduates earn more than academic graduates. However, their earnings increase little with experience. Strengthening general education within the vocational education system and stronger incentives to participate in life-long learning could enhance adaptability of German workers to technological change.

Figure E. Most German youth are either in employment, education or in training

Youth not in employment, education or training (NEET), per cent of 15-29, 2016 or latest year



1. Unweighted average.

Source: OECD (2017), *OECD Education Statistics* (database).

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More modular training offers, combined with opportunities to formally recognise skills acquired on-the-job, can boost life-long learning, as experience in Denmark and Portugal suggests.

Policies to improve skills and better skills use boost inclusive growth

Impressive progress has been made in reducing the impact of socio-economic background on education outcomes, as improved PISA scores and a steep rise in childcare enrolment show. There is scope to further improve education outcomes among children with weakest socio-economic background. Ensuring high-quality childcare and early childhood education as well as that high-quality full-day primary schooling is available everywhere would allow making progress in this direction.

Better opportunities for women to develop their careers would boost productivity and reduce poverty risk. Women are overall as highly educated as men but their skills are used less, in part because they often work fewer hours, limiting professional choice and career prospects. Further developing full-day childcare and reducing the tax and social security disincentives for second earners, mostly women, to work longer hours and further strengthening fathers' incentives to take care of their children would improve gender equity.

Transport policy reform can contribute to green growth and boost wellbeing

Emissions from transport have increased despite substantial gains in efficiency, leaving a weak spot in the overall climate policy mix. Transport infrastructure plans need to be made consistent with CO₂ emission reduction targets, including by expanding the electric charging infrastructure for automobiles. Policies to deploy ICT-based ride sharing, coupled with congestion charging, facilitate the low-carbon transport transition, help deploy effective public transport at lower cost, and can boost competitiveness of cities by reducing congestion.

MAIN FINDINGS	KEY RECOMMENDATIONS
Supporting steady inclusive growth with financial and budgetary policies	
The budget balance is above the medium-term deficit objective of 0.5% of GDP. Additional government spending is needed to expand full-day primary schooling, high-quality childcare, life-long learning and roll out high-speed fibre broadband infrastructure. Rising life expectancy will raise pension spending.	Use fiscal leeway in a prudent manner, taking capacity constraints into account, to lower the taxation of low wage earnings and to raise priority spending on childcare, education and life-long learning as well as for low-emission transport infrastructure. Index the legal pension age to life expectancy.
Performance-related budgeting can free room for priority spending.	Introduce spending reviews more broadly at the federal and <i>Länder</i> level and use them to reallocate funding across broad spending fields.
Strengthen productivity and prepare for the future of work	
Self-employed workers are less well covered by social safety nets than dependent workers. This can increase precarious employment and poverty risk while discouraging some potential entrepreneurs. Failed entrepreneurs must stand ready to pay back debt for up to 6 years, depending on how much debt they have paid back. This discourages entrepreneurship.	Make enrolment in public old-age pension mandatory for the self-employed who are not covered by old-age pension insurance. Open access to public health insurance to all self-employed. Ease the conditions for bankrupt entrepreneurs to be discharged of debt after three years, while maintaining adequate safeguards for creditors.
E-government services are underdeveloped, raising administrative costs of entrepreneurs. The scope of available services differs across municipalities and information is scarce.	Create a one stop shop to process all procedures for starting up a company online.
Regulation barriers, such as rules on exclusive activities, hamper competition in some services.	Reduce restrictive regulation in the professional services, safeguarding quality standards and consumer interests.
Government ownership in business sector activities holds back the reallocation of resources. The limited number of infrastructure suppliers in mobile networks limits competition and innovation which keeps prices high.	Privatise government stakes in the <i>Landesbanken</i> , car manufacturing, telecommunications and postal services. Use the upcoming radio spectrum auction to promote competition in the mobile market.
Boosting skills and skills use	
The earnings gap between men and women is large, especially for the well-educated. Joint income taxation lowers incentives for second earners in couples, women in most cases, to work full time. Second parents, mostly fathers, take little parental leave. If both fathers and mothers share parental leave more equally, gender norms about child-raising and household responsibilities rebalance.	Lower the tax burden on the wage income of second earners. Increase the minimum amount of time the second parent has to take parental leave, from the current two months, for the couple to receive the maximum leave entitlement.
The impact of socio-economic background on educational attainment and cognitive skills is still strong. Children with weak socio-economic background are less likely to attend high-quality childcare institutions. Most children attend half-day primary education.	Raise quality standards in childcare and early childhood education. Expand primary education to high-quality full-day education programmes.
Literacy skills are relatively low among young people in vocational education coming from lower secondary schools.	Strengthen general education within vocational schools, and maintain the strong labour market orientation of vocational education and training.
Participation in life-long learning is lower than in leading countries. There is little validation of informal skills acquired on the job. This reduces incentives to participate in life-long learning, especially for unskilled and older workers. Unskilled adults face low-pay and unemployment risks.	Offer more training programmes for the modular acquisition of qualifications in life-long learning and foster the recognition of skills acquired on-the-job. Strengthen support for unskilled adults to obtain professional qualifications.
Boosting green growth	
The CO ₂ emissions from the transport sector are high and have not fallen. The federal transport infrastructure plan is inconsistent with CO ₂ emission reduction targets. Pollution from transport has high costs to human health especially in cities, while road congestion reduces productivity.	Extend charging station infrastructure to promote electrification of road transport. Develop congestion pricing. Remove regulatory hurdles to ride sharing services and allow them to serve public transport.



From:
OECD Economic Surveys: Germany 2018

Access the complete publication at:
https://doi.org/10.1787/eco_surveys-deu-2018-en

Please cite this chapter as:

OECD (2018), "Executive summary", in *OECD Economic Surveys: Germany 2018*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/eco_surveys-deu-2018-2-en

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