

# ADDRESSING SHORTFALLS, MODERNISING RESOLUTELY

Annual Report 2024/25

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Scientific Staff of the German Council of Economic Experts

Jade Hochschule Wilhelmshaven, 26 November 2024

This presentation only reflects the personal opinion of the presenter and not necessarily that of the German Council of Economic Experts.



**SACHVERSTÄNDIGENRAT**  
*zur Begutachtung der  
gesamtwirtschaftlichen Entwicklung*

**Who are we?**

**What is the mandate of the German Council of Economic Experts?**



# Who we are

## Council members



Prof. Dr. Veronika Grimm



Prof. Dr. mult. Dr. h.c. Ulrike Malmendier



Prof. Dr. Dr. h.c. Monika Schnitzer  
(Chairwoman)



Prof. Dr. Achim Truger



Prof. Dr. Martin Werding

## Scientific staff



## Liaison office

Office manager  
7 employees

Interns

# Goals and mandate

**Founded** in 1963 by law

## Goals

- Supporting the government in **analysing economic problems**
- Reduce the influence of vested interests by **informing the public**

## Mandate

- Periodic **assessment** of the overall economy (incl. **forecast**)
  - Since 1964: **GCEE Annual Report** in November
  - From 2014 to 2023: **Economic update** in March
  - Since 2024: **Economic update combined with in advance released chapters** in May
  - Additional **special reports** (on initiative or commissioned by the federal government)
- Identifying undesirable developments and ways to avoid them
- **Independent**, only bound by legal mandate

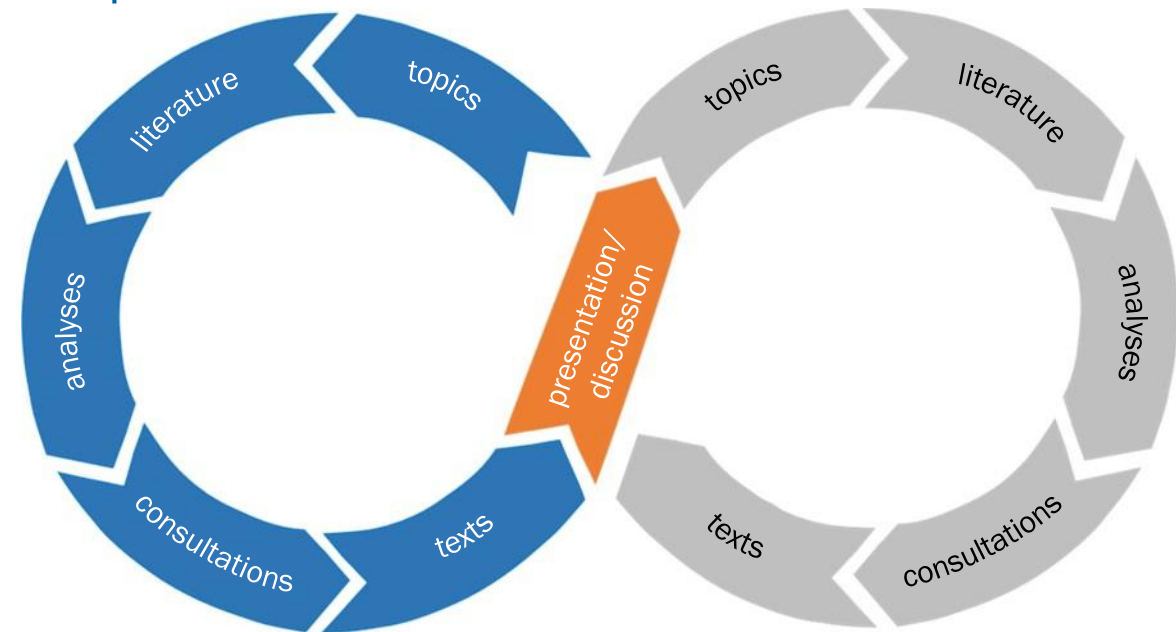
# How is the GCEE Annual Report produced?

**Identifying topics** in the first half of the year

- Discussion of possible topics / work on analyses
- Consultation with key players (ministries, Bundesbank, associations, etc.)

**“Kampagne”**: intensive work on the annual report

- Twice per year
  - September to November
  - March to May
- Completion of the forecast usually one week before printing process



# Interested in an internship with us?



## ✓ Always in the thick of it

- ✓ Participate in council meetings and meetings with other scientists
- ✓ Contribute to the report by analysing data, reviewing literature, and drafting text



## ✓ Part of the scientific staff:

Collaborate closely with the team



## ✓ Name of intern is mentioned in annual report



## Upcoming application deadlines (but also review on rolling basis):

- ↘ 30 November 2024
- ↘ 28 February 2025
- ↘ 31 May 2025
- ↘ 30 August 2025



**Duration:** Usually two to four months



**Compensation:** At least 240 euros per week, depending on the progress of studies or degrees obtained.



# Structure of the Annual Report 2024/25

1

No recovery despite  
growing global  
economy

2

Strengthening the  
future-orientation of  
public finances

3

Enabling digital  
innovations in the  
financial sector,  
securing financial  
stability

4

Housing in Germany:  
Eliminating shortages,  
facilitating access

5

Freight transport  
between infrastructure  
requirements and  
decarbonisation



A large blue container ship is shown from a side-on perspective, sailing on the ocean. The ship's deck is densely packed with multi-colored shipping containers (red, yellow, blue, and white). The ship's hull is a vibrant blue, and the sky above is filled with soft, grey clouds. The ship is moving from left to right across the frame.

**No recovery despite growing  
global economy**

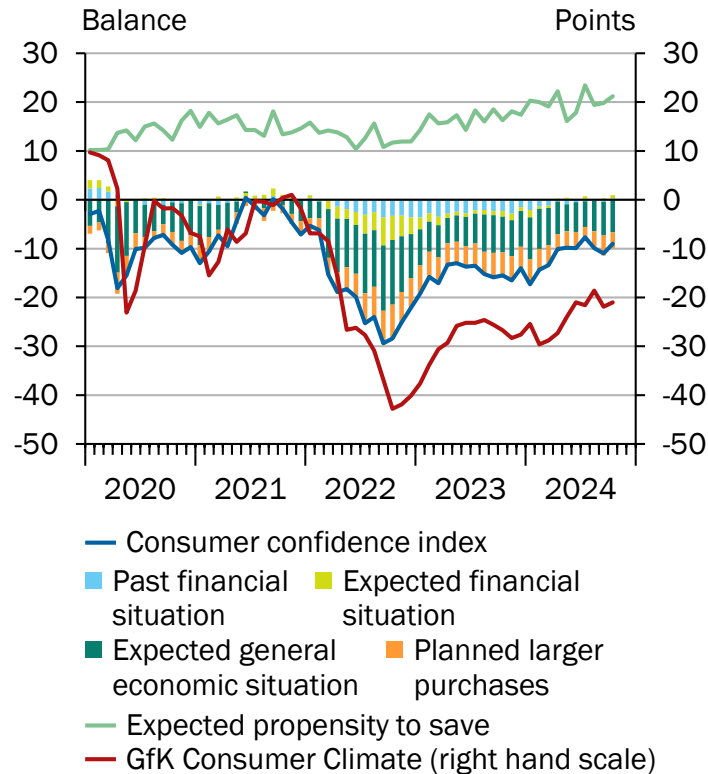
# Main determinants of the forecast

	Initial situation	Forecast horizon	Opportunities/risks
Consumer behaviour	Income growth only leads to low consumption	Increased savings rate, income growth declines	Savings rate falls more than expected/ geopolitics & inflation
Manufacturing	Increased costs, monetary policy & uncertainty	Negative impact on services, monetary policy supports	Deepening industrial weakness
Labour market	Labour market still robust	Labour market stagnates	Reallocation to productive sectors/ unemployment

# Consumption increases only slightly despite rising incomes

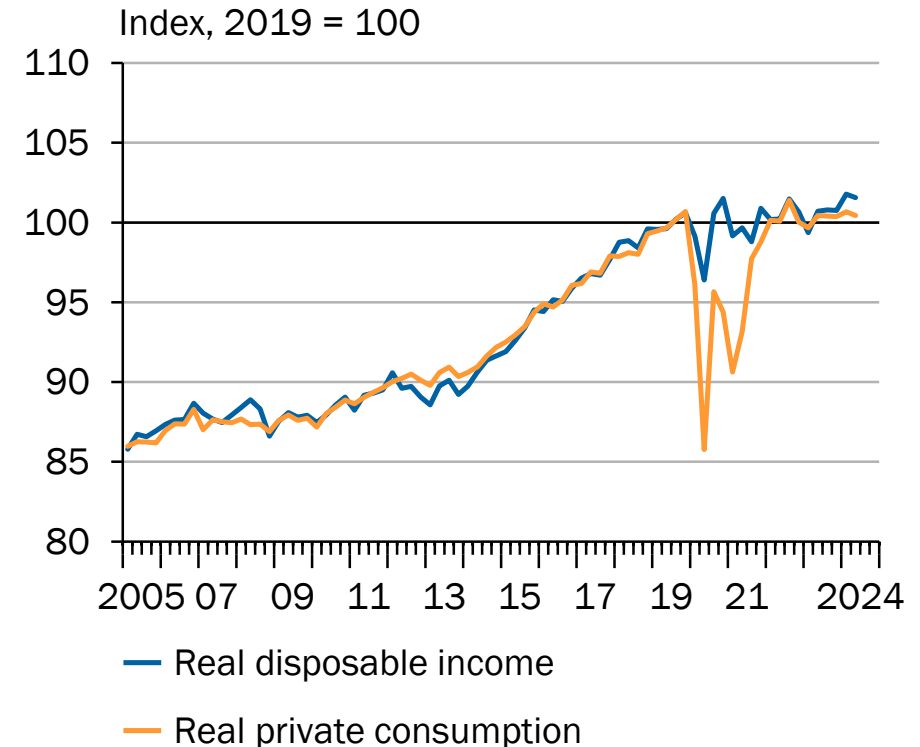
Consumer expectations remain negative – income growth likely to slow down

## Low consumer confidence mainly due to negative expectations for the future



Sources: European Commission, GfK, own calculations  
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## Disposable income is currently rising stronger than consumer spending

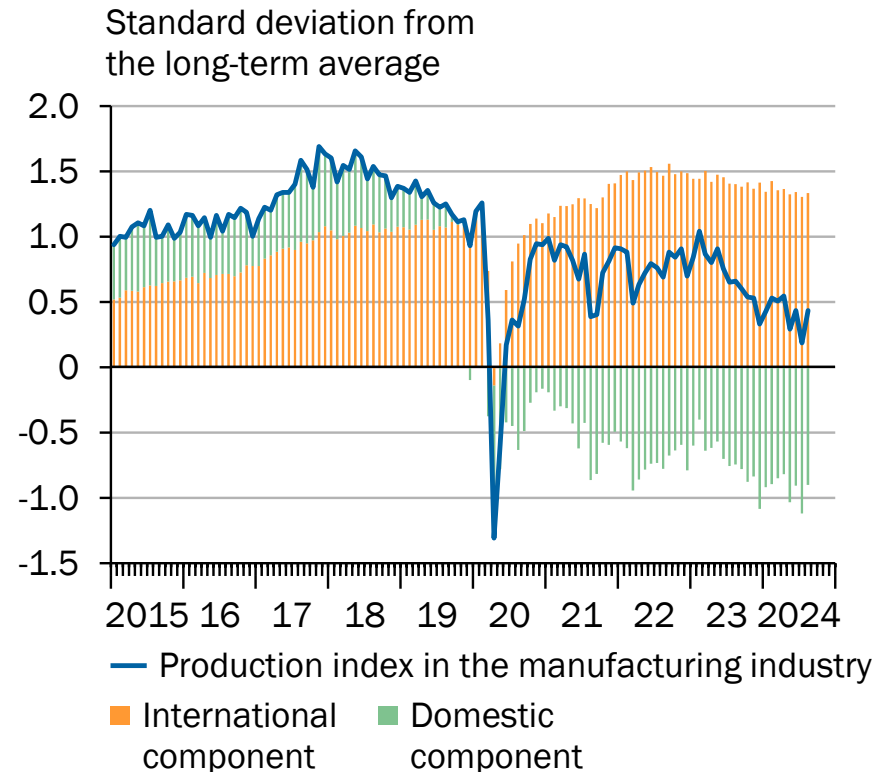


Sources: Federal Statistical Office, own calculations  
© German Council of Economic Experts | 24-052-04

# German industry has been under pressure since 2017

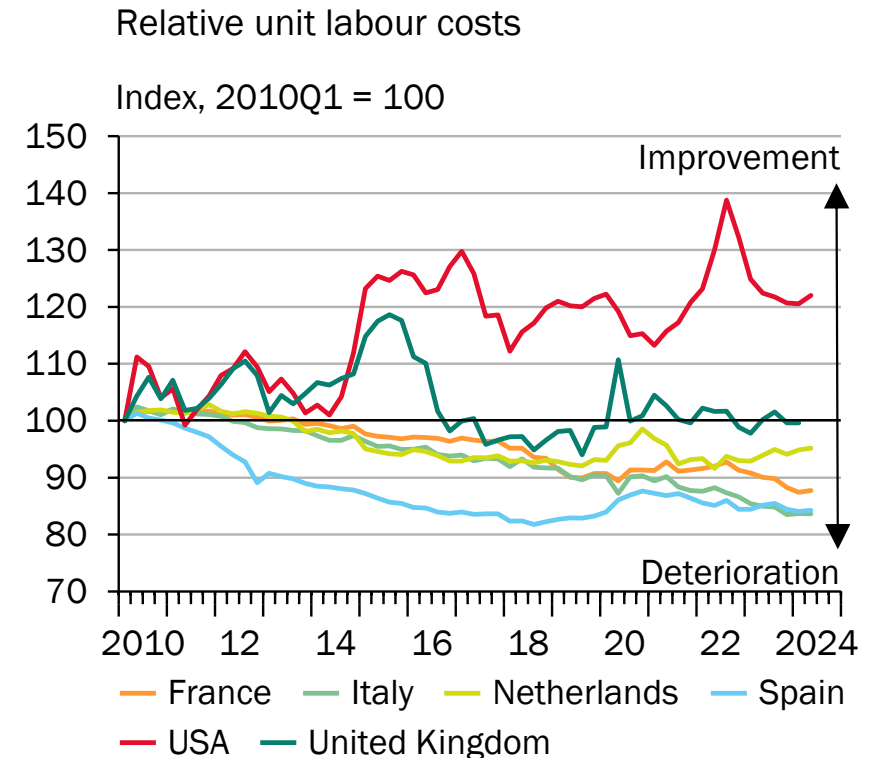
Decoupling from global manufacturing cycle – labour & energy became relatively more expensive

## German industrial production declines primarily due to domestic factors



Sources: OECD, own calculations  
© German Council of Economic Experts | 24-265-04

## Labour has become more expensive, especially compared to the large EU member states

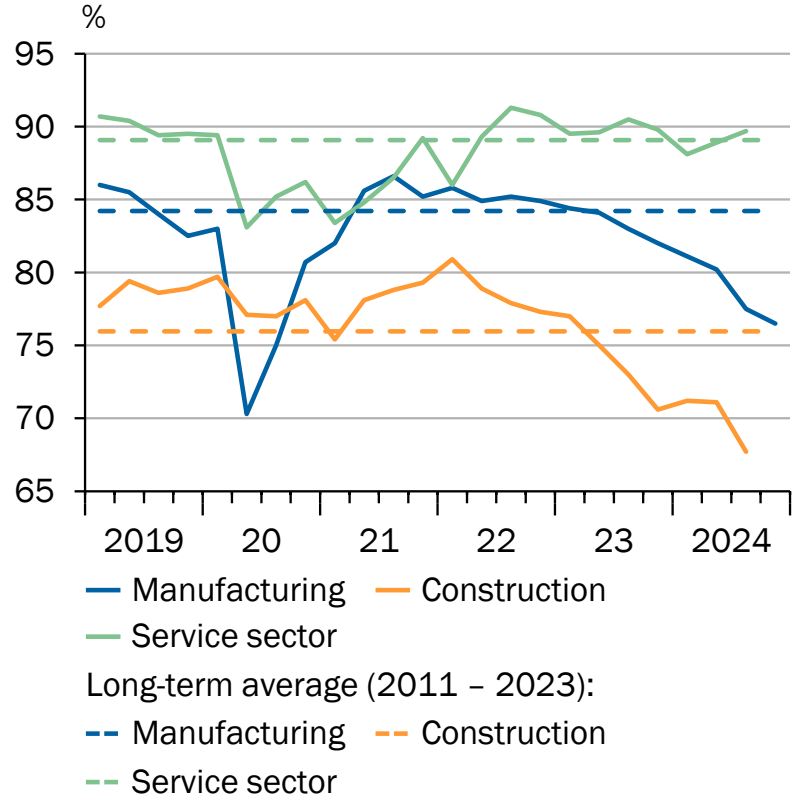


Sources: BEA, Deutsche Bundesbank, Eurostat, ECB, National Bureau of Statistics China, own calculations  
© German Council of Economic Experts | 24-265-04

# Low capacity utilisation and uncertainty weigh on investments

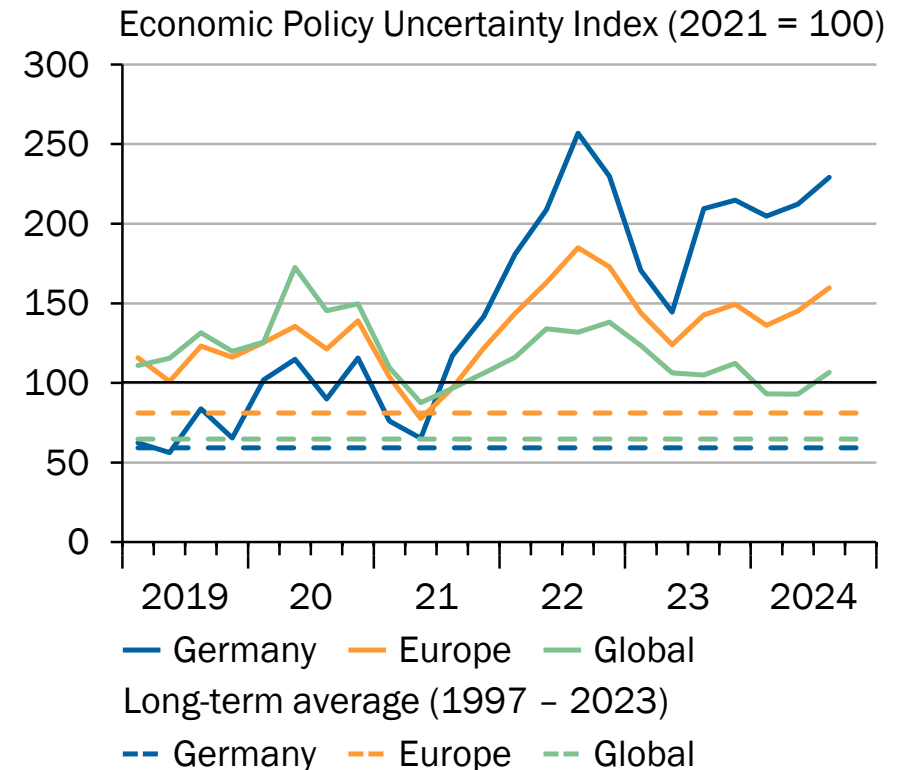
Low capacity utilisation reduces investment demand, reinforced by wait-and-see behaviour

## Capacity utilisation in the capital-intensive manufacturing sector fell sharply



Sources: European Commission, Ifo  
© German Council of Economic Experts | 24-016-04

## Significant increase in economic policy uncertainty in Germany

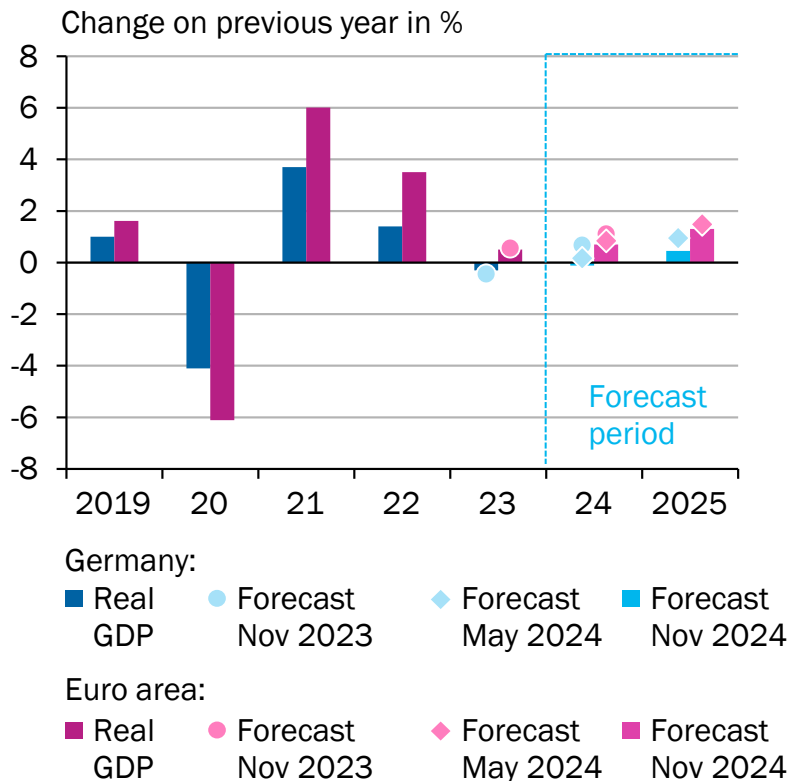


Sources: Baker et al. (2016), own calculations  
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# Economic recovery in the eurozone and Germany

Only slight growth expected in Germany in 2025

**At 0.4%, German GDP is likely to continue to grow more slowly than in the eurozone in 2025**



**Inflation normalises, unemployment rises, wage growth declines, deficit still elevated**

Key economic indicators (in %)

	2023	2024	2025
<b>Germany</b>			
GDP growth	- 0.3	- 0.1	0.4
Inflation rate	5.9	2.2	2.1
Unemployment rate	5.7	6.0	6.1
Wage growth	6.6	5.2	3.5
Budget balance	- 2.6	- 2.1	- 1.9
<b>Euro area</b>			
GDP growth	0.5	0.7	1.3
Inflation rate	5.4	2.4	2.1
<b>Global economy</b>			
GDP growth	2.8	2.6	2.6
Inflation rate	5.3	4.6	3.0

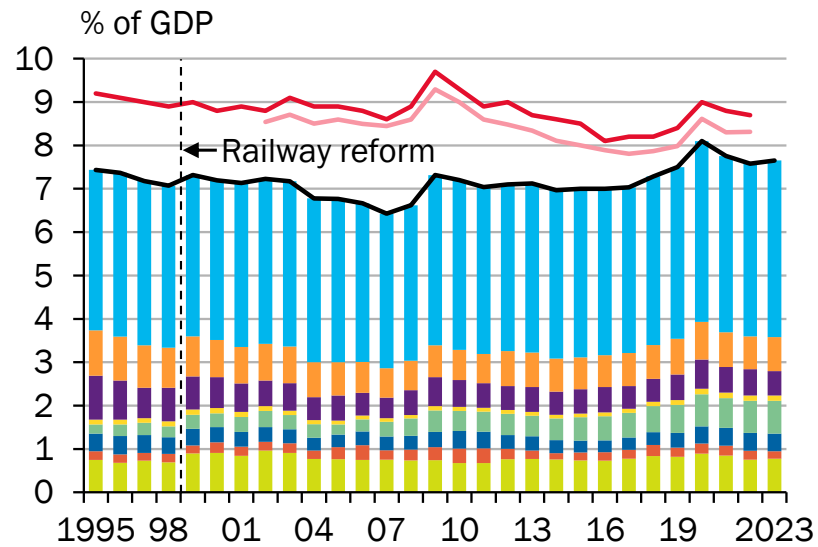


## **Strengthening the future-orientation of public finances**

# Future-oriented public spending has been low

... leading to shortfalls in the areas of transport infrastructure, defence and education

Future-oriented public spending has for decades been lower in Germany than the EU average...

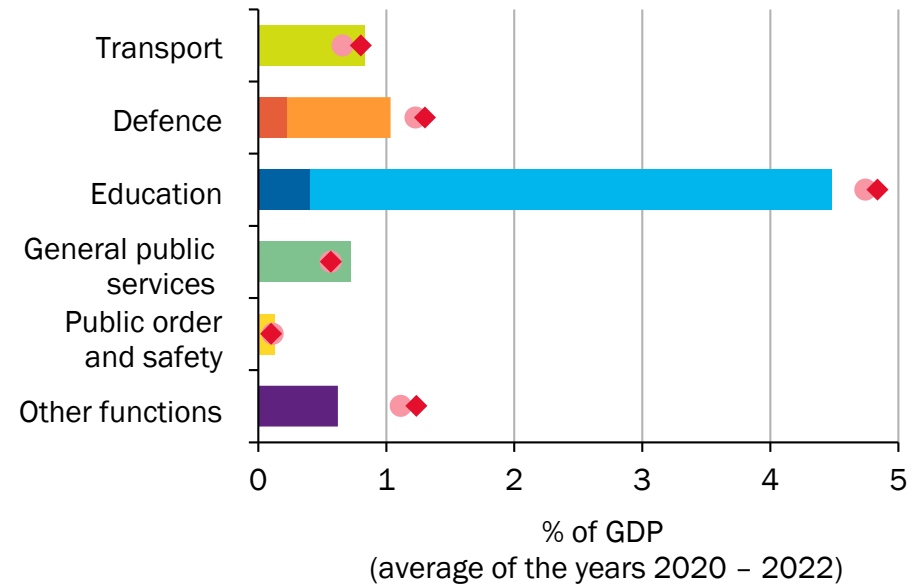


Investments: ■ Transport ■ Defence ■ Education ■ General public services  
■ Public order and safety ■ Other functions

Non-investment expenditure: ■ Defence ■ Education

— Total Germany ◆ Total EU27 ◆ Total EU11

... especially in defence and education

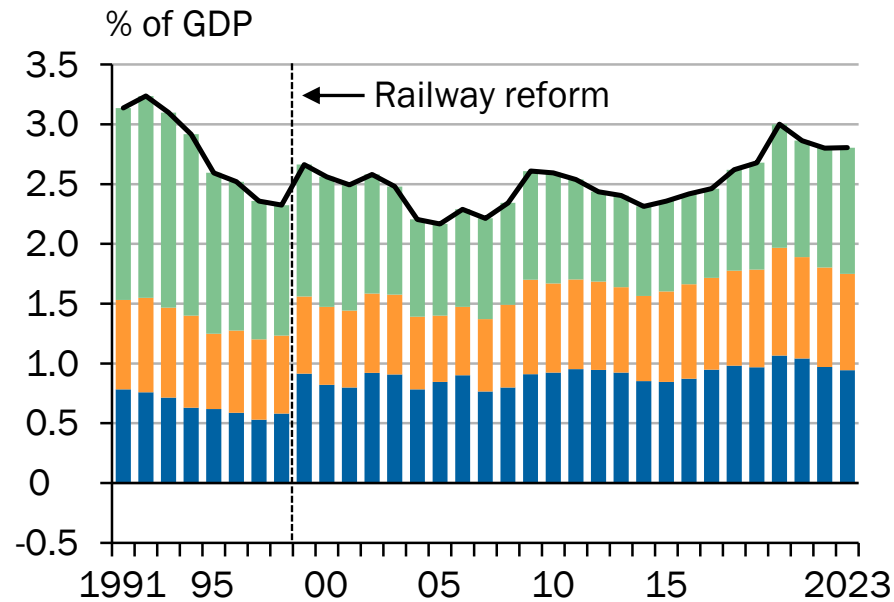




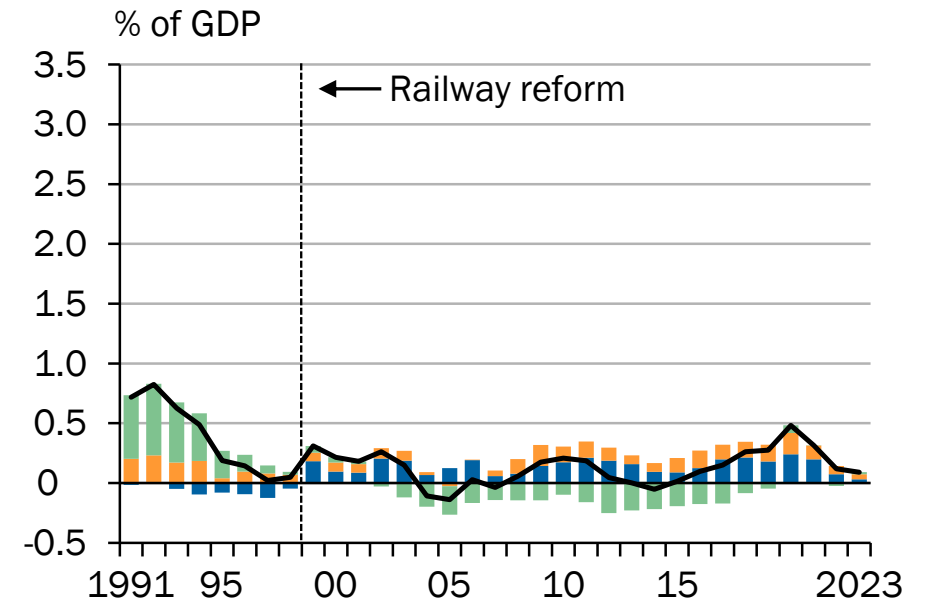
# Narrow definition of investment in national accounts

Although gross development is on an upward trend, net development is not

Gross fixed capital formation since the 2000s increased...



... but net capital expenditure is close to zero and recently declining

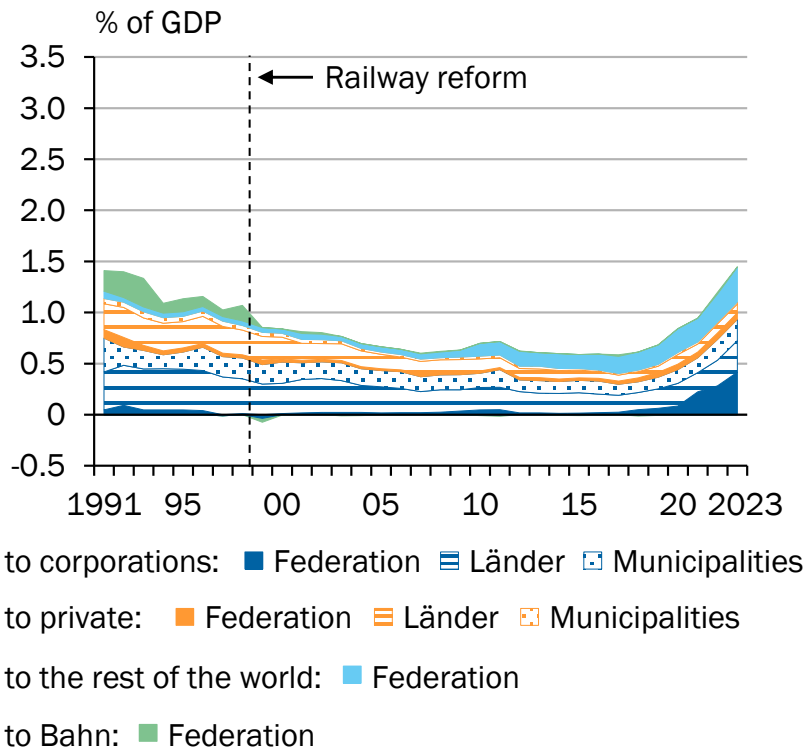


■ Federation ■ Länder ■ Municipalities — Total regional authorities

# Extending the concept of investment shows that...

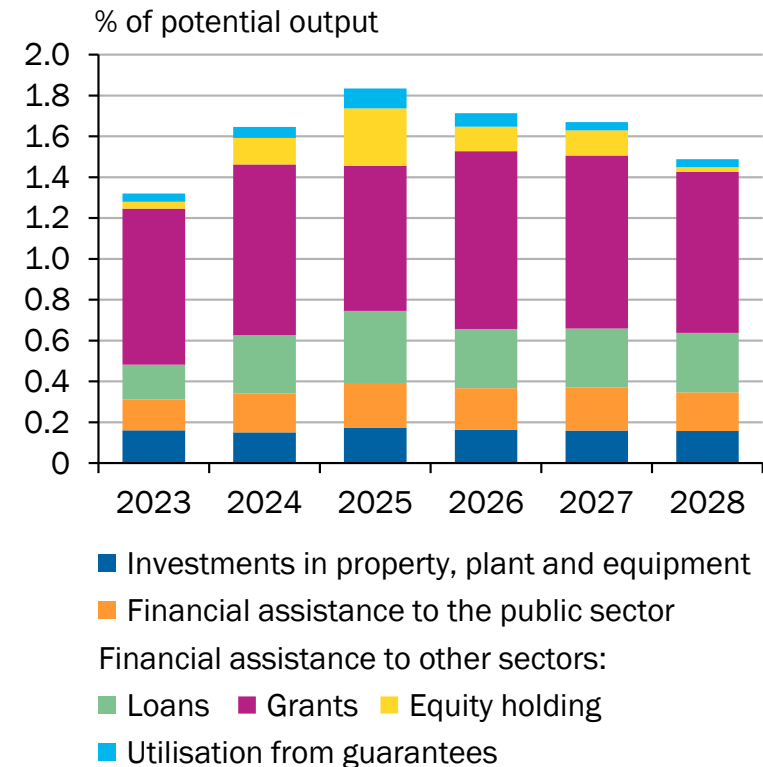
... investment grants have increased and investments in the federal budget are likely to decline

## Investment grants (IG) have increased significantly since 2020



Sources: Federal Statistical Office, own calculations  
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## Investments in the federal budget increase, but decline over the planning horizon



Sources: BMWK and BMF (2024), Deutscher Bundestag (2024), own calculations  
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# As a result, there is a need to catch up

... especially in the three areas of transport infrastructure, defence and education

## Transport infrastructure

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- The degree of modernisation of public infrastructure has decreased significantly
  - Almost half of the bridge surface is in only adequate or worse condition
  - Congestion and traffic jams impair freight transport and economic activity

## Defence

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- Defence spending exceeds NATO's two per cent target for the first time in 2024
  - Target is currently only achieved with SV Bundeswehr
  - Significantly lower in the decades before
- Equipment is outdated

## Education

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- Poor condition of school infrastructure, lack of early childhood care
- Poor performance of pupils

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**Cumulative backlog demand in the three-digit billion range in the next five years alone**

# Obstacles to future-oriented public spending

Present bias, tighter fiscal space, bureaucratic hurdles and construction capacity

## Lower prioritisation of future-oriented spending due to policymakers' present bias



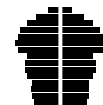
### Fiscal illusion

- Incomplete perception of fiscal effects by citizens



### Political "Tragedy of the Commons"

- Insufficient consideration of joint debt in deficit financing



### Old electorate

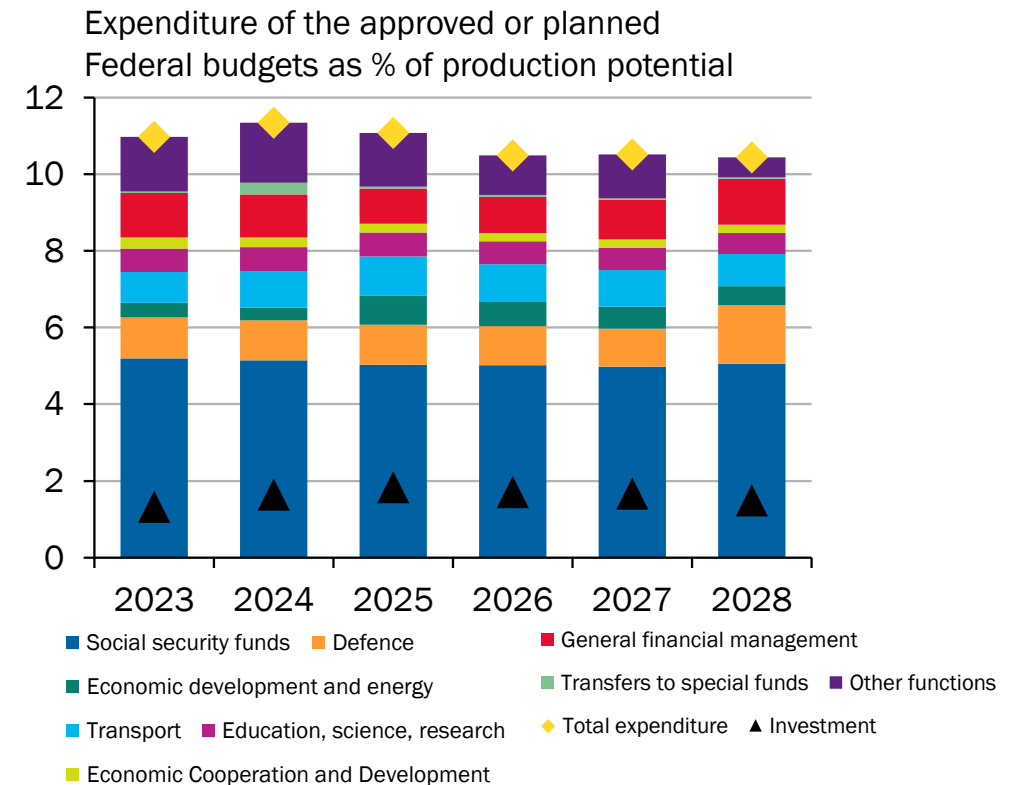
- Low weight on future economic development



### Frequent changes of government together with limited terms of office

- Incentive to achieve "quick" results

## Narrowing fiscal space in the federal budget



# Goals and measures

Three **Goals** and seven possible **Measures**

1

## Facilitate expenditure prioritisation

- Use ex-ante analyses to enhance the basis for decision-making  
↳ ITEMS 139 F.
- Develop transparent and methodological standards for cost-benefit analyses  
↳ ITEMS 139 FF.

2

## Secure and stabilise future- oriented expenditure

- Transport infrastructure fund with committed own revenues  
↳ ITEM 177
- Minimum quotas for long-term financing in the areas of defence and education  
↳ ITEM 178 F.

3

## Expand the fiscal space for future-oriented public spending

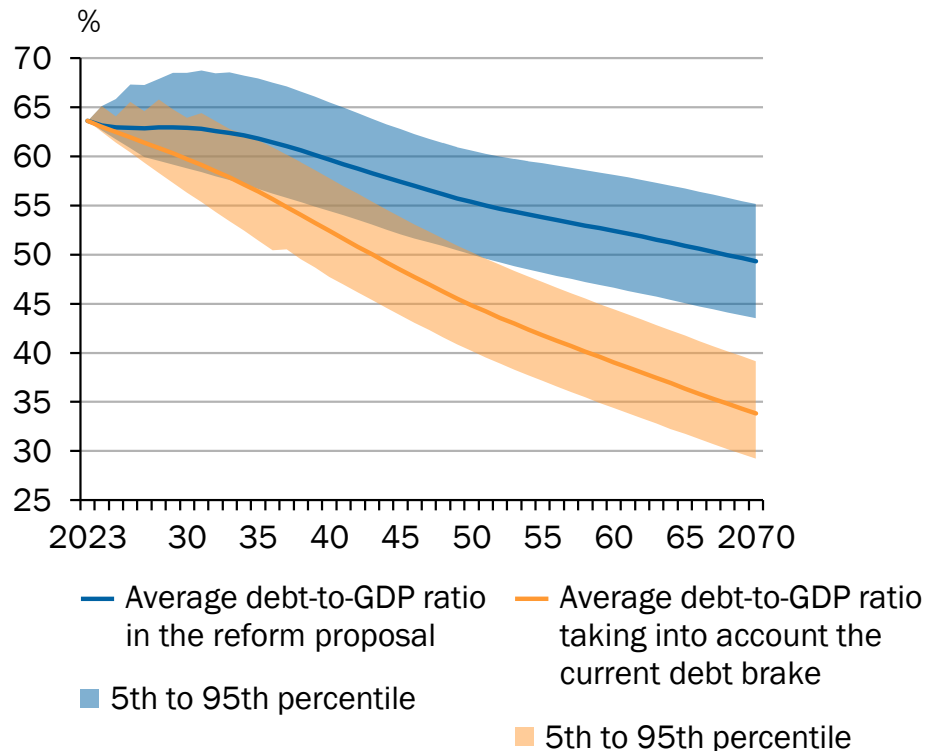
- Continuous ex-post monitoring and evaluation ↳ ITEM 168
- Institutionalise sunset clauses  
↳ ITEM 169
- Reform the debt brake to increase the flexibility of fiscal policy without jeopardising stability ↳ ITEMS 170 FF.

## Expand the fiscal space for future-oriented public spending

### Stability-oriented reform of the debt brake

... can increase the flexibility of fiscal policy, but does not ensure forward-looking spending

### Decreasing debt ratio with transition phase & debt-dependent deficits



Source: own calculations  
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### Design of the debt brake

- ↳ Transition phase after application of the exception clause
  - ↳ Strengthen recovery and avoid frequent exceptions
- ↳ Increase structural deficit limit when debt ratios are low
  - ↳ deficit limit depending on the level of debt
 

over 90 % of GDP	→	0.35 % of GDP
between 60 % and 90 % of GDP	→	0.5 % of GDP
below 60 % of GDP	→	1.0 % of GDP
- ↳ Repayment of emergency and transitional loans after five years within 20 years

Secure and stabilise future-oriented expenditure

# Various options for increase possible

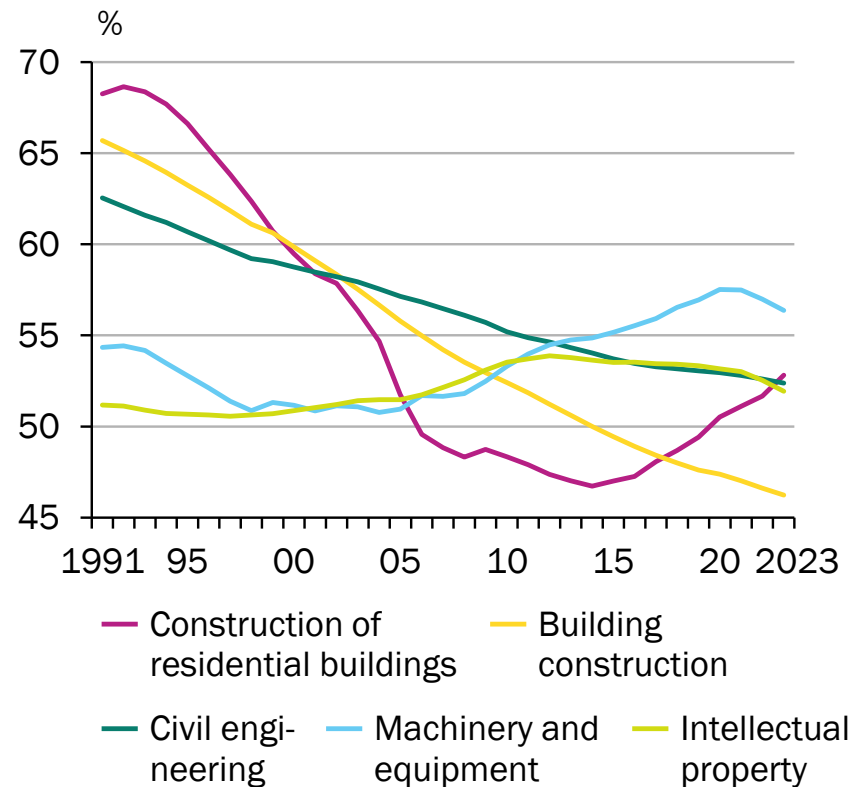
... but not all of them effective

Criterion	Option			
	Minimum quota	Special funds	Public companies	Golden rule
Expansion of fiscal space	No	Without loans: No With loans: Yes	(Yes)	(Yes)
Explicit prioritisation of future-oriented expenditure	Yes	(Yes)	(Yes)	(Yes)
Stabilisation of future-oriented expenditure	Yes	With own revenue: Yes Without: Restricted	(Yes)	Yes
Constitutional amendment necessary	Yes, for high binding effect	Yes, for high binding effect	No	Yes
Possible undesirable side effects	Rigid	With loans: Relocation of investments	Lack of transparency and legal risks	Possible expansion of fiscal space for consumption, unlimited increase of debt if cap is missing

# Credibly stabilise spending on transport infrastructure

Continuous, long-term expenditure is important to increase construction capacity

## Degree of modernity of public buildings and infrastructure has fallen sharply



Sources: Federal Statistical Office, own calculations  
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### Measure

Transport infrastructure fund to increase and stabilise investment in the transport sector



Provide long-term funding with income from the core budget

- Do not expand consumer spending
- Improve predictability



Anchoring in the German constitution (basic law)

- Strengthening the binding effect



Intermodal design

- Coordinating mobility goals



Limited credit authorisations, if necessary, to...

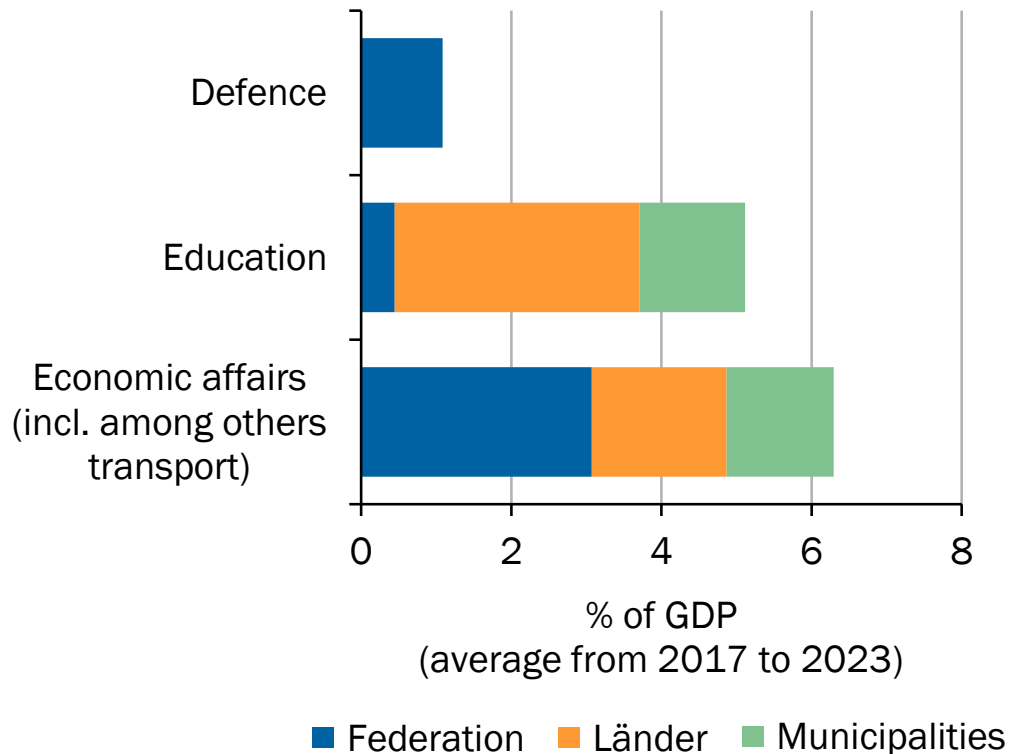
- Address pent-up demand
- Balance out economic fluctuations



# Ensure spending on defence and education

... to remedy accumulated deficiencies and adapt to new realities

**Division of tasks: federal level responsible for defence, Länder responsible for education**



Measure

Minimum quotas for a binding increase of expenditure



**Defence:** Orientation towards the NATO 2 per cent target

- Modernising military equipment
- Reduce bureaucratic hurdles



**Education:** Minimum expenditure, e.g. per pupil

- Implement by law at state level
- Nationwide coordination makes sense

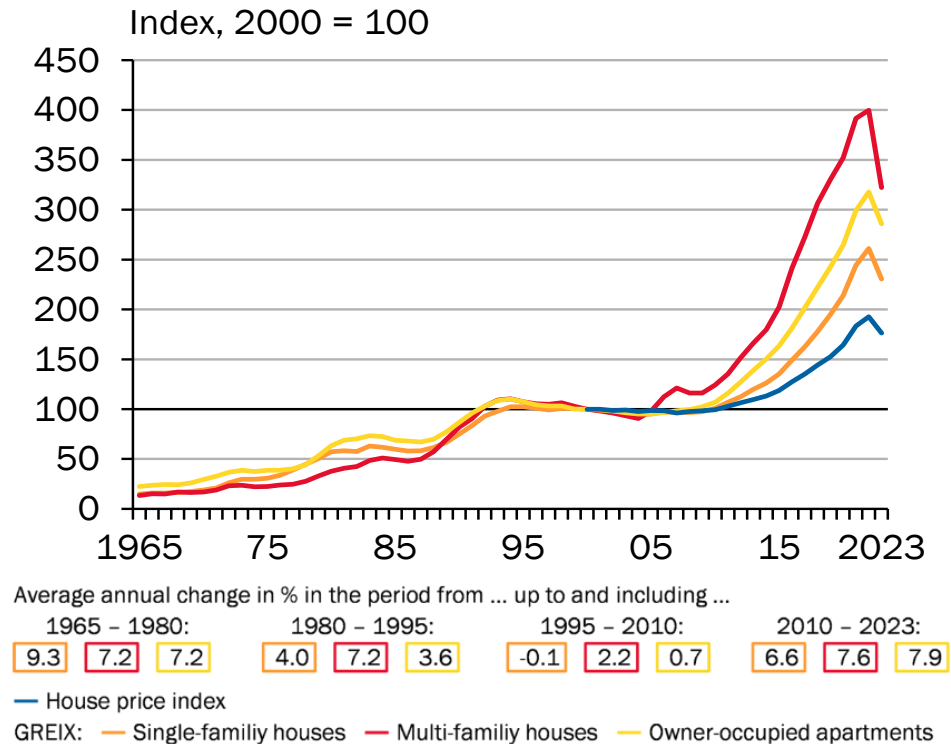
A photograph of a cityscape at sunset. The sky is a mix of orange, yellow, and red, with the sun low on the horizon. In the foreground, there are several multi-story buildings. One prominent building is light-colored with many windows. To its right, a building has a sign that says "APOTHEKE" with a green cross. In the background, there are more buildings, some with cranes, and a tall chimney. A white text box is overlaid on the left side of the image.

# **Housing in Germany: Eliminating shortages, facilitating access**

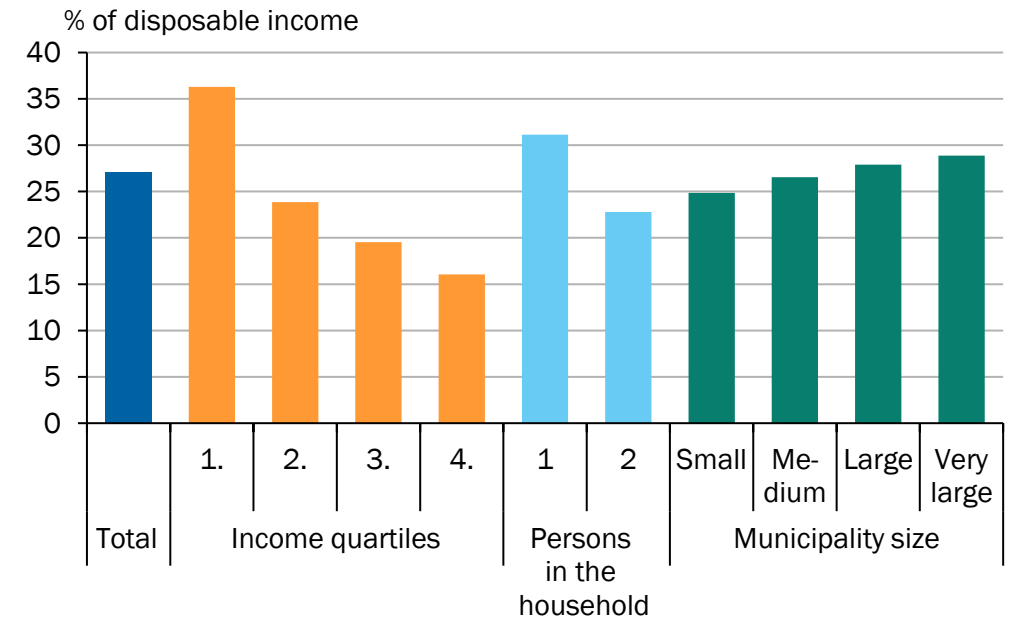
# Housing shortages

... are a macroeconomic and social problem

## Sharp rise in residential property prices since 2010



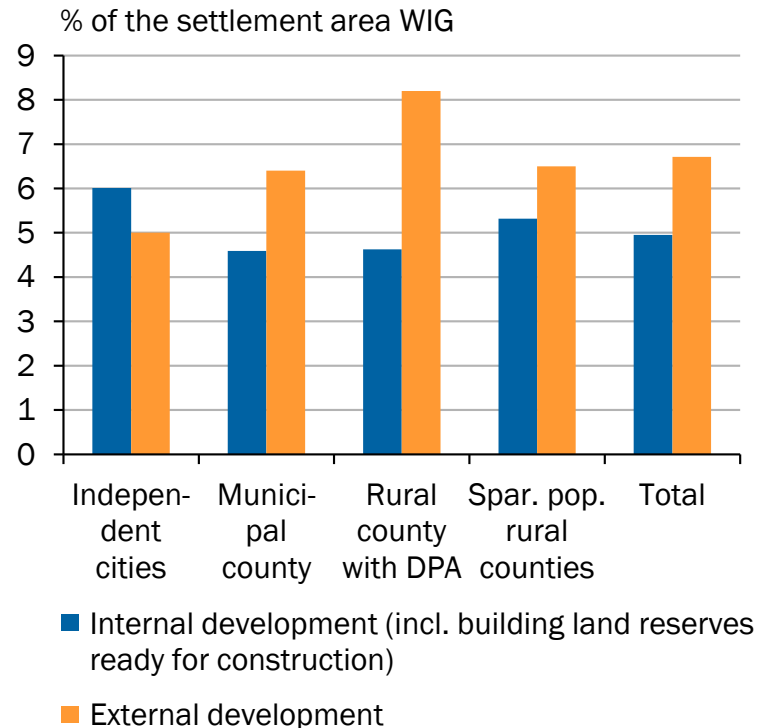
## Some population groups are particularly affected by high rent burden



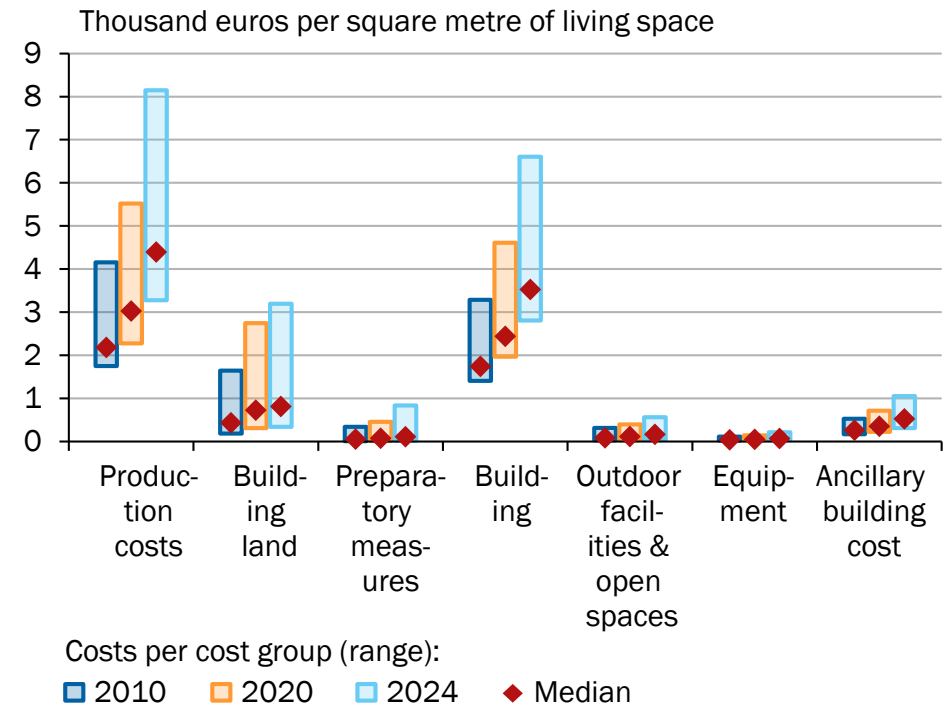
# Strengthening new residential construction

... by increasing availability of building plots and reducing construction costs

## Make use of building plots and increase density through tax incentives



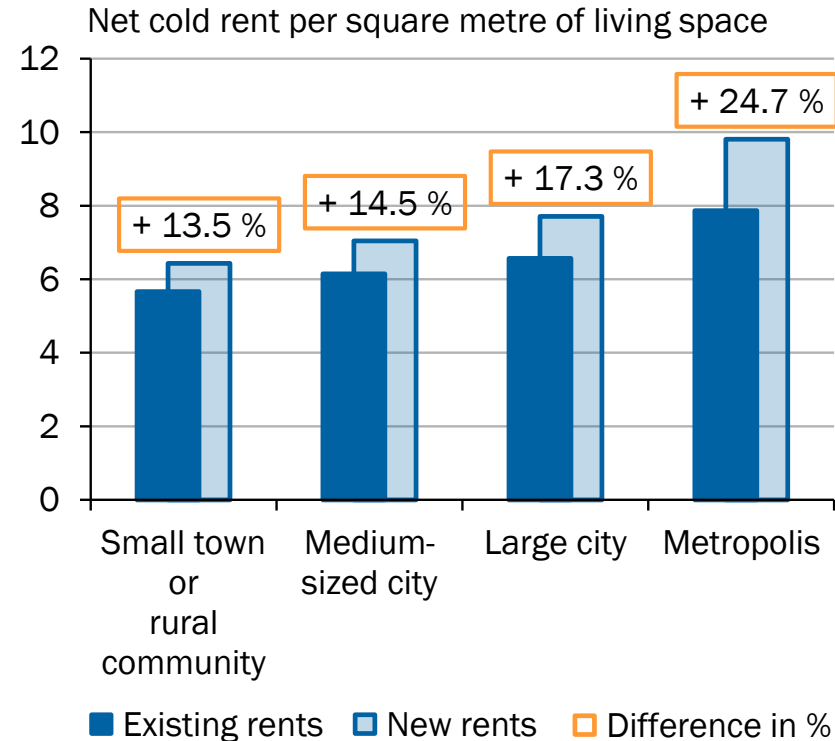
## Reduce construction costs through more flexible and harmonised building regulations



# Utilising available housing more efficiently

... by removing barriers to relocation

## Less regulation of rents to reduce the gap between new and existing rents



## Reducing ancillary purchase costs can facilitate property transactions



Real estate transfer tax (3.5 – 6.5 %)



Notary fees (1 – 2 %)

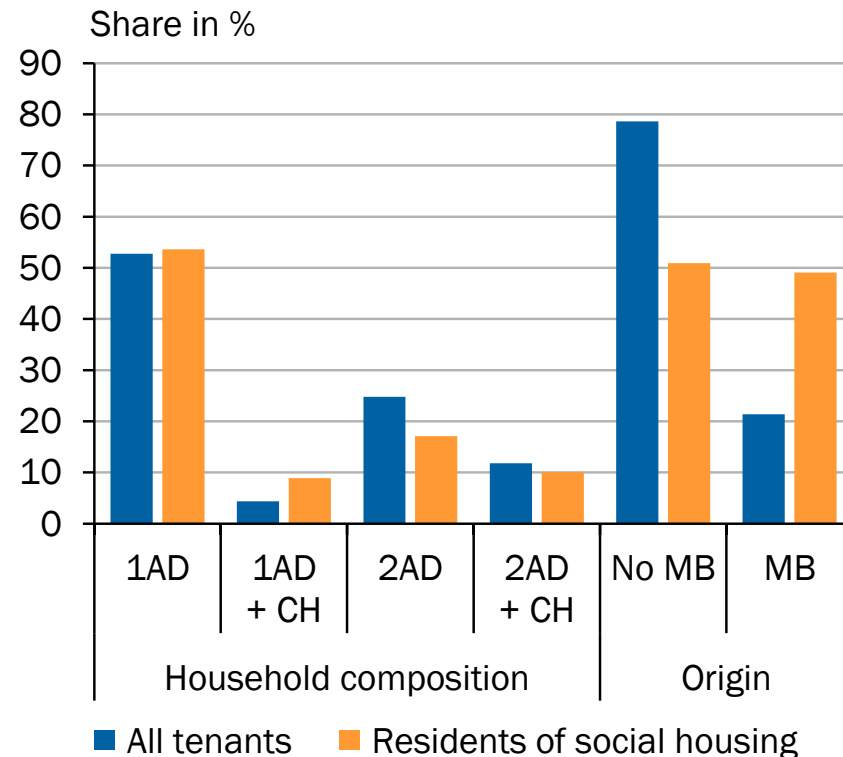


Real estate agent fees (6 – 7 %)

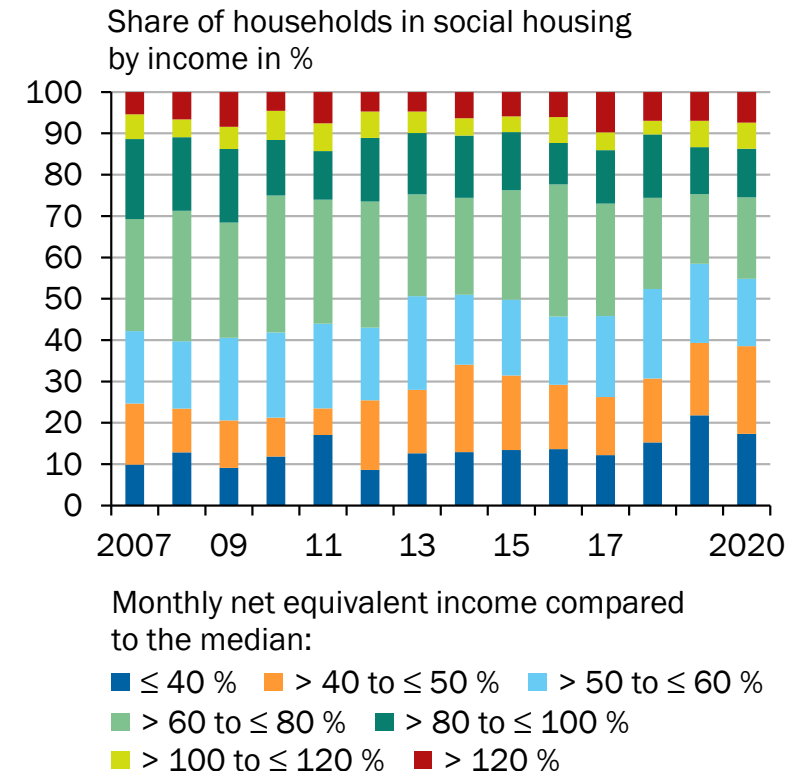
# Complementary design of social policies for housing

Policies tied to beneficiaries and to buildings should complement each other

**Social housing promotion ensures access for disadvantaged groups...**



**... but may be misallocated. It should be designed in a more targeted manner**



# THANK YOU FOR YOUR ATTENTION.



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