EUROPEAN COMMISSION

Brussels, 30.5.2012
SWD(2012) 305 final

COMMISSION STAFF WORKING DOCUMENT

Assessment of the 2012 national reform programme and stability programme for GERMANY

Accompanying the document

Recommendation for a

COUNCIL RECOMMENDATION

on Germany's 2012 national reform programme and delivering a Council Opinion on Germany's stability programme for 2012-2016

{COM(2012) 305 final}

CONTENTS

EXECUTIVE SUMMARY

In 2012, Germany's economic activity is expected to significantly slow down as compared to 2011. Real GDP is projected to increase by 0.7%. Unemployment is foreseen to further drop to 5.5%.

Germany's public finances are improving. Helped by robust economic growth in 2011, Germany has reduced its budget deficit to 1% of GDP. The government has proposed a major reform of the country's energy system, which aims at ensuring competitive energy prices, a high level of energy security and effective environmental and climate protection. In other areas, reform efforts have been limited, particularly as regards labour market participation, education and services.

Germany faces a number of problems in the medium to long term. Demographic change will hamper its future growth potential and the sustainability of its public finances. The current account surplus has been narrowing gradually. Parts of the German financial sector remain vulnerable, and, in particular, some of the *Landesbanken* lack a viable business model. Shortages of skilled labour are emerging in some sectors while scope remains to increase labour market participation. The performance of the education system can be improved, in particular with regard to disadvantaged groups. The energy regulatory framework and the network infrastructure will have to adapt to deliver on the agreed energy reform. Problems of competition remain in the services sectors and in the network industries, in particular in the railway sector.

1. INTRODUCTION

In June 2011, the Commission proposed four country specific recommendations[1] (CSRs) for economic and structural reform policies for Germany. In July 2011, the Council of the European Union adopted these recommendations[2], which concerned public finances, the financial sector, the labour market, and services and network industries. In November 2011, the Commission published its Annual Growth Survey for 2012 (AGS 2012) in which it set out its proposals for building the necessary common understanding about the priorities for action at national and EU level in 2012[3]. It focused on five priorities — growth-friendly fiscal consolidation, restoring normal lending to the economy, promoting growth and competitiveness, tackling unemployment and the social consequences of the crisis, and modernising public administration — and encouraged Member States to implement them in the 2012 European Semester.

Against this background, Germany presented updates of its national reform programme and stability programme in April 2012. These programmes give details of Germany's progress since July 2011 and of its future plans. This Staff Working Document assesses Germany's implementation of the 2011 recommendations and how the AGS 2012 priorities are taken into account, identifies the country's current policy challenges and, in this light, examines its latest policy plans.

Overall assessment

Economic growth was robust in 2011 and Germany managed to reduce its fiscal deficit below the 3% of GDP reference value two years ahead of the deadline set by the Council. Germany plans to meet its medium-term budgetary objective already in 2012 and to achieve virtually balanced nominal budgets as from 2014. It is pursuing an ambitious strategy to reform its energy system and has adopted legislation that should help stimulate competition in the electricity and gas sectors. Notwithstanding these significant achievements, reform efforts in other areas have been limited, in particular regarding the labour market, the financial sector, the railway sector and other services sectors. Therefore, the challenges identified in July 2011 and reiterated in the AGS 2012 remain valid.

Demographic change poses a major challenge for Germany's potential growth in the medium to long term. This possibly has implications for public finances and the labour market, and highlights the importance of boosting productivity and efficiency through structural reforms. In addition, a properly functioning and efficient financial sector is a pre-requisite for economic growth.

Overall, the policy plans submitted by Germany are relevant, but in some areas they lack sufficient ambition to address the challenges identified. The national reform programme confirms that Germany will continue with its current strategies and announces new plans in the areas of public finance, the financial sector, the labour market, education, social policy, technology and innovation, resource efficiency and competition. For some of these areas, the national reform programme does not contain any specific plans for addressing the challenges, for instance regarding fiscal disincentives to work for second earners, even though declining labour input is likely to have a significant adverse effect on potential growth. As regards reforming the *Landesbanken* sector and stimulating competition in certain sectors, Germany's plans appear relatively unambitious.

[1] SEC(2011) 807 final
[2] OJ C 212, 19.7.2011, p. 9.
[3] COM(2011) 815 final

2. ECONOMIC DEVELOPMENTS AND CHALLENGES

2.1. Recent economic developments and outlook

The strong rebound of the German economy after the pronounced initial impact of the crisis continued in 2011. Given the country's large export-oriented manufacturing sector and specialisation in investment goods, real GDP had contracted by an unprecedented 5.1 % amid the international crisis in 2009. The economy has seen a vigorous recovery after the recession, with real GDP expanding by a solid 3.0 % in 2011, after 3.7 % in 2010. However, the momentum of economic growth slowed in the course of the year as the crisis deepened and uncertainty increased. Real GDP saw a slight quarterly decline by 0.2 % in the fourth quarter. Domestic demand was the main driver of real GDP growth in 2011, benefiting inter alia from the economy's sound fundamentals including strong labour market performance, strong competitiveness and corporate balance sheet positions and the comparatively limited need for household and public balance sheet adjustments. While private consumption saw its largest increase in 5 years, gross fixed capital formation also expanded markedly. Exports remained dynamic but the solid increase of imports on the back of strong domestic demand limited the positive growth contribution of net exports, contributing to a narrowing of the German current account surplus to around 5¾% of GDP. The labour market continued to show a very strong performance, with unemployment at the lowest level in 20 years as the unemployment rate declined to an annual average of 5.9 %, thus being one of the lowest in the EU. Inflation remained elevated, with a 2.5 % increase in consumer prices as measured by the Harmonised Index of Consumer Prices (HICP). High energy prices were a key factor for this acceleration, seeing a 10 % increase over the year.

According to the Commission's spring 2012 forecast, real GDP is set to expand by 0.7 % for 2012 as a whole, with activity expected to strengthen in the course of the year as the crisis-related uncertainty slowly dissipates, followed by 1.7 % in 2013. Available indicators have recently signalled some stabilisation. The German economy's fundamentals remain essentially sound, while the economy also benefits from a noticeable monetary stimulus, both boding well for domestic demand as a key growth driver, helping to reduce external imbalances in the euro area. Domestic demand is expected to expand by 1.2 % in 2012 and 1.9 % in 2013. Still favourable labour-market developments should support private consumption, while investment, currently held back by the crisis-related uncertainty, should benefit from favourable financing conditions. Export prospects should also strengthen in the course of the year. The international debt crisis and high oil prices remain the main risks to the German growth outlook. The labour market's strong performance is set to continue, with additional increases in employment and a further gradual reduction in unemployment. Amid increasing labour market tightness, wage growth of close to 3 % is expected in both 2012 and 2013, following a lengthy period of wage moderation where wages did not always increase in line with productivity. Inflationary pressures from oil prices are projected to contribute to an average consumer price inflation rate of 2.3 % as measured by the Harmonised Index of Consumer Prices this year. With moderating commodity prices and in spite of rising domestic inflationary pressures given the increasing labour market tightness, inflation should return to below the 2 % benchmark in 2013.

Commission's estimates indicate that potential growth could average around 1¼% in 2011-15. The economy's medium-term growth prospects have thus not been significantly dented by the crisis; there is no evidence of a lasting impact on the labour market or on prospects for total factor productivity growth in the coming years, while investment prospects also remain sound.

The national reform programme and the stability programme share the same macroeconomic outlook for the programme period, which is broadly in line with the Commission's spring 2012 forecast for 2012-13 as regards real GDP growth and its main drivers. Labour-market developments in 2012 as projected by the government appear somewhat pessimistic, while inflation in 2012 is likely to be higher than in the programme's scenario[4]. The programme's outlook for medium-term growth (averaging slightly more than 1½% over the programme period, thus slightly above the estimated potential growth rate of close to 1½%) is broadly in line with the Commission's estimates of Germany's potential growth rate.

Germany submitted its national reform programme to the Commission on 12 April 2012 and its stability programme on 18 April 2012. Both documents were adopted by the Council of Ministers on 21 March and 18 April 2012 respectively.

The national reform programme and the stability programme give a clear picture of Germany's fiscal consolidation efforts and the key structural reforms underpinning macroeconomic stabilisation. The national reform programme evaluates the progress made in meeting national targets for employment, R&D, education, energy and climate change, and poverty reduction for 2020. These targets point the direction in which Germany needs to go in order to continue modernising its economy; they also put the more immediate reform priorities in a broader context. The national reform programme also assesses Germany's progress in implementing the 2011 country specific recommendations and its 2011 commitments under the Euro Plus Pact, and it describes the measures Germany plans to take to fulfil its obligations under the Pact. The stability programme covers the period 2012-2016.

2.2. Challenges

Germany's recent economic performance has been good, but it faces a number of inter-related challenges in the medium and long term. Demographic change, for example, is expected to affect its potential growth[5]. The potential increase in labour productivity will probably not be sufficient to compensate for the negative impact on growth of the decline in the workforce.

In the medium to long term, increasing labour market participation and human capital should be the priority. The German labour market is performing remarkably well, but there is scope for further raising participation among certain groups, notably among women, low-skilled workers, low-wage earners, people with a migration background and older workers, and for attracting skilled workers from abroad. People on 'mini-jobs' and long-term unemployed are particularly at risk. Moreover, raising education outcomes, in particular those of disadvantaged groups, would improve productivity and address emerging skilled labour shortages.

It is also important to promote potential growth by increasing productivity. Encouraging competition in the services sectors and network industries would foster productivity growth. Despite considerable progress in recent years, there is scope for further improvement. In the electricity and gas sectors, effective implementation of the legislation adopted recently should stimulate competition. Competition in the railway sector remains weak. Although Germany is close to its national R&D intensity target and is one of the innovation leaders in the EU, when

[4] The outlook underlying the programmes is based on the government's January 2012 Economic Projections. Updated projections published after the submission of the programmes are more closely in line with the Commission Services' outlook also regarding the labour market and inflation.

[5] According to the European Commission's 2012 Ageing Report, Germany is projected to register the lowest annual average potential growth rate over the period 2010 to 2060 (0.8% vs 1.4% in the EU-27). The annual average potential growth rate in Germany is expected to decrease from 1.2% in 2010-2020 to 0.8% in 2051-2060, although it should remain relatively stable for the EU as a whole.

compared with key competitors worldwide there is still scope for fostering R&D and innovation.

Germany is pursuing a major reform of its energy system. The new energy strategy opens the door to new opportunities for growth, but it also involves challenges in terms of potentially high costs and the possibility of capacity constraints, in particular those caused by delays in the deployment of infrastructure. If the energy strategy is to be successful, the overall economic costs need to be minimised by, for example, continuously improving the cost-effectiveness of the renewables policy, boosting competition in the energy sector and taking further decisive steps to foster energy efficiency. Moreover, developing the infrastructure, and ensuring sufficient storage and generation capacity, are essential if the strategy's goals are to be achieved.

Demographic change also poses a challenge for the sustainability of public finances. In order to pursue budget consolidation in a growth-friendly manner, which is one of the priorities of the annual growth survey 2012, it is important to exploit all the available potential for increasing growth-enhancing spending on education and research as well as for improving the efficiency of expenditure policies (e.g. health care and long-term care, education and infrastructure) and the tax system (e.g. by limiting the use of reduced VAT rates and tax expenditure, or shifting taxation towards tax bases that are relatively less harmful to growth).

A stable and efficient financial sector is key to ensuring adequate credit flows in an economy, thereby underpinning investment and economic growth. The crisis did not lead to a credit crunch, but it did reveal vulnerabilities in large parts of the German financial sector, notably exposing the structural weaknesses of the state-owned *Landesbanken*. Public support measures, a strengthened regulatory framework, the sector's own adjustment efforts and the cyclical upturn appear to have stabilised the financial sector as a whole. Further reform of the *Landesbanken* sector, together with further strengthening of the supervisory framework, would contribute to increasing the long-term stability of the financial sector and the efficiency of capital allocation in the economy.

3. ASSESSMENT OF POLICY AGENDA

3.1. Fiscal policy and taxation

Budgetary developments and debt dynamics

Germany has made significant progress in implementing last year's recommendation which called for implementing the budgetary strategy and bringing the high public debt ratio on a downward path in line with the Council recommendations under the excessive deficit procedure and ensuring an adequate structural adjustment effort towards the medium-term budgetary objective thereafter. The programme specifies the previous medium-term budgetary objective of a structural deficit of ½% of GDP (interpreted as a narrow range around 0.5 % of GDP), which adequately reflects the requirements of the Stability and Growth Pact, to imply a deficit not exceeding 0.5 % of GDP. The country met the objective of the 2011 stability programme and its commitment under the Euro Plus Pact to bring the deficit below the 3 % of GDP reference value already in 2011, thus two years ahead of the deadline set by the Council. The main goals of Germany's medium-term budgetary strategy as set out in the 2012 stability programme are to meet the medium-term budgetary objective of a structural deficit not exceeding 0.5 % of GDP already in 2012 and to reach virtually balanced nominal budgets as from 2014.

Having stood at 3.2 % of GDP in 2009 and 4.3 % of GDP in 2010, the general government deficit in Germany was brought down to 1 % of GDP in 2011. This improvement was driven by favourable cyclical conditions, the robust labour market, the phasing-out of stimulus measures, fiscal consolidation efforts and the fading-out of the one-off impact of financial sector stabilisation measures on the deficit in the previous year. Furthermore, the transfer of large portfolios of assets to 'bad banks' considerably raised interest expenditure and interest income without, however, having a noticeable impact on the overall budget balance.

Box 1. Main measures

Germany adopted a consolidation package ('*Zukunftspaket*') in 2010 covering both revenue and expenditure. In the light of the favourable budgetary development in 2011, the federal government decided not to implement additional measures to offset, for example, the fall in revenues from the nuclear fuel tax and delays in introducing a financial transaction tax. Moreover, in December 2011 it adopted a draft law which aims at reducing fiscal drag *(kalte Progression)* in income taxation. The draft tax reform foresees an increase in the basic income tax allowance, a proportional adjustment of the tax scale as well as regular biannual assessments of the need to adjust for fiscal drag. The federal government also confirms its intention of retaining the increased level of spending on education and research after the current legislative period. The Special Investment and Redemption Fund, which was established as part of the 2009 stimulus package in order to fund additional public investments, expired at the end of 2011. Measures with a limited budgetary impact include a tax simplification act, the modified financing of the Energy and Climate Fund based entirely on the proceeds from the auctioning of emission allowances and a federal transport infrastructure programme. Reduced transfers between the federal budget and social insurances and the advance contributions to the basic capital of the ESM do not affect the general government budget balance. The possible impact of the temporarily reactivated Financial Market Stabilisation Fund on public deficit or debt cannot be forecast.

Main budgetary measures

Revenue	Expenditure
2012	
• n.a.	• n.a.
2013	
• Tax reform aimed at reducing fiscal drag, to be implemented in two steps in 2013 and 2014 (in total -0.2 % of GDP)	• n.a.

Note: The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure. The degree of detail reflects the type of information made available in the stability or convergence programme and, where available, of a multiannual budget.

The 2011 deficit turned out to be significantly below the target of 2½% of GDP set in the 2011 stability programme. After controlling for the denominator effect of the higher-than-expected growth, the more favourable deficit outcome is the result of a stronger increase in revenues as well as lower expenditure growth than initially planned, which together more than offset the less favourable starting position due the upward revision of the 2010 deficit by 1 percentage point (pp) of GDP. Based on the better starting position at the end of 2011, deficit targets have been revised down by ½% of GDP for each subsequent year of the programme period (see Table III in the annex). The nominal deficit is planned to remain at about 1% of GDP in 2012 and to drop to ½% of GDP in 2013, which is broadly in line with the Commission's spring 2012 forecast of a deficit of 0.9% of GDP for 2012 and 0.7% of GDP for 2013. However, the latter does not factor in the estimated revenue loss of 0.1% of GDP in 2013 that would result from the proposed tax reform, since it is still due for adoption by the Federal Council (see Box 1). All levels of government are expected to contribute to consolidation. Balanced budgets for social security funds and surpluses for local governments are foreseen as from 2013, while federal and *Länder* budgets would be virtually balanced by 2015.

The stability programme plans a decreasing expenditure-to-GDP ratio, in particular resulting from below-average growth in social transfers other than in kind on the back of the robust labour market, the phasing-out of additional public investments undertaken as part of the 2009 stimulus package and slower growth in interest expenditure due to the lower interest rates. No consolidation measures in addition to the 2010 package are envisaged. Moreover, the stability programme factors in an expected reduction in the contribution rate to the statutory pension insurance from currently 19.6% to 19.2% in 2013 on account of the projected increase in the sustainability reserve (*Nachhaltigkeitsrücklage*). One-off measures are not foreseen throughout the programme period.

According to the stability programme, the (recalculated) structural deficit[6] will improve from 0.8% of GDP in 2011 to 0.5% of GDP in 2012 and 0.3% of GDP in 2013, which is broadly in line with the Commission's forecast of a structural deficit of 0.4% of GDP in 2012 and 0.3% of GDP in 2013. A slightly positive structural balance is planned as from 2014. Hence, Germany would respect its medium-term budgetary objective throughout the programme period, which should also be the case taking into account the risk assessment. According to the information provided in the stability programme, also taking into account the risk assessment, and to the Commission's forecast, the growth rate of government expenditure, net of discretionary revenue measures, will in 2012 exceed the so-called lower reference rate, while in 2013 it will be below the then applicable benchmark reference medium-term rate of potential GDP growth.

After having dropped to 81.2% of GDP in 2011, gross debt is planned, according to the stability programme, to increase again to 82.0% of GDP in 2012 due to the euro area stabilisation measures, before falling to 80% of GDP in 2013 and remaining on a downward path thereafter - resulting from consolidation efforts, the denominator effect of GDP growth, reduced support to the banking sector and the winding-up of 'bad banks' (see Table IV in the annex). This is broadly in line with the Commission's forecast of a debt-to-GDP ratio of 82.2% in 2012 and 80.7% in 2013, which does not consider potential gains from the winding-up of 'bad banks'. Following the correction of the excessive deficit, Germany is in a transition period and, according to plans, is making sufficient progress towards compliance with the debt reduction benchmark. According to the Commission's forecast, progress towards compliance with the debt reduction benchmark is indeed sufficient.

Overall, the budgetary targets appear realistic, unless the growth outlook should need to be revised significantly. However, budgetary risks may arise if additional measures to stabilise the financial sector turn out to be required. In particular, the expected transfer of a second portfolio of assets of WestLB bank to the related 'bad bank', which has not yet been specified, is likely to further increase the debt level in 2012.

[6] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the programme, using the commonly agreed methodology.

Long-term sustainability

The long-term change in age-related expenditure is the same as the EU average. The initial budgetary position offsets the long-term costs. Under a no policy change assumption, debt would fall to 68.5% of GDP by 2020. Additional fiscal consolidation beyond the forecast horizon would be needed to make progress towards the reference value for government debt beyond the short-term. Full implementation of the programme would reduce debt further by 2020, but it would still be above the 60% of GDP reference value. Ensuring sufficient primary surpluses over the medium-term and beyond would improve the sustainability of public finances.

The annual growth survey 2012 recommended prioritising growth-friendly expenditure. The federal and *Länder* governments already agreed in 2008 to increase general government spending on education and research to 10% of GDP by 2015[7]. In this context, the federal government appears to be well on track to meet its commitment to spend an additional EUR 12 bn on education and research between 2010 and 2013 and plans to retain the increased expenditure level thereafter. However, it is important that commitments are also met by the *Länder* and municipalities, which provide the bulk of the expenditure on education and research, and that the efficiency of public spending in these areas is further increased (see section 3.3). Furthermore, the federal government has taken measures to improve the efficiency of public spending on health care and has proposed a reform of long-term care. The 2011 health care reform has slowed down expenditure growth in the short term, thanks mainly to cost reductions for pharmaceuticals. However, additional efforts to improve efficiency in health care are needed to contain further expected expenditure increases in the medium term due to demographic change and technological advances in medicine. The proposed reform of long-term care, including an extension of benefits for dementia patients in particular, an increase in the contribution rate of 0.1 pp, and fiscal incentives for voluntary private insurance, is also unlikely to be sufficient to cope with expected cost increases in the future.

Fiscal frameworks

The introduction of the constitutional debt brake has further strengthened Germany's fiscal framework which, moreover, includes an established medium-term budgetary planning framework and independent institutions providing economic and tax revenue forecasts as well as fiscal policy advice[8]. The debt brake stipulates, as a matter of principle, structurally balanced budgets for both the federal and *Länder* governments from 2016 and 2020 respectively. At the federal level, the debt brake took effect in 2011, accompanied by the introduction of top-down budgeting, and will be fully phased in by 2016. Detailed provisions in the Federal Constitution and in the implementing rules should allow for an effective application of the debt brake at the federal level. However, no significant progress has been made in addressing the recommendation on completing the implementation of the budgetary rule at the *Länder* level and the national reform programme does not mention any specific measure addressing it.

The implementation at *Länder* level is the sole responsibility of the respective *Länder*. Only five *Länder* have enshrined balanced budget rules in their Constitutions or plan to do so. A

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[7] The Federal Statistical Office estimates total expenditure on education, research and science in 2008 at EUR 154 bn or 8.6% of GDP, whereas about 21% of total expenditure originated from the private sector and foreign sources. Hence, general government expenditure amounted to EUR 122 bn or 6.8% of GDP, of which 14% (EUR 17 bn) was spent by the federal government and 84% (EUR 105 bn) by the *Länder* and municipalities (Statistisches Bundesamt (2011), *Bildungsfinanzbericht 2011*).

[8] For a detailed description of the fiscal framework in Germany, see European Commission (2012), *Fiscal frameworks across Member States: Commission services country fiches from the 2011 EPC peer review*, European Economy, Occasional Papers 91, p104-113.

further six *Länder* have included balanced budget rules in their budget laws, although these could be amended using ordinary legislative procedures[9]. Municipalities are not explicitly covered by the *Länder* debt brakes, and implementing provisions have not yet been specified or they vary across *Länder.* At the moment, only Rhineland-Palatinate plans to use a (virtual) control account like the one established at the federal level. The control account records deviations in budget execution from the authorised level of borrowing as debits or credits, which are then carried over to reduce or increase the permitted level of net borrowing in the following year. This appears to be an important feature in ensuring effective enforcement of the debt brake. Only those five *Länder* who are in a particularly difficult fiscal position have additional compliance incentives; they receive consolidation assistance from the federal government and from the other *Länder,* which would be cancelled in the event of non-compliance with the agreed consolidation path[10]. Moreover, indicators and reference values applied under the enhanced monitoring through the Stability Council may not always be suitable to identify the risk of budgetary distress at an early stage. In particular, there is still no agreed methodology for the cyclical adjustment of budget balances at *Länder* level.

Tax systems

Building on the recent progress in fiscal consolidation, Germany could benefit from addressing the existing inefficiencies in the German tax system in the light of the tax policy priorities in the annual growth survey 2012. The resulting additional revenues could support continued budgetary consolidation and/or be used to reduce the fiscal burden on labour with a view to promoting employment and medium- to long-term potential growth in response to the major challenge of demographic change. In this context, the tax burden on low-wage earners, mainly low-skilled workers, and second earners is of particular importance (see section 3.3).

First of all, there is scope for improving the efficiency of the VAT system by reducing the application of the reduced rate (of currently 7 %) to a rather wide range of goods and services amounting to about 18 % of the VAT base in 2007. Experience has shown that a broad application of reduced VAT rates is inefficient, since it distorts consumption behaviour, and could potentially result in substantial fiscal revenue losses and sizeable administrative and compliance costs. Possible distributional effects could be addressed in a more targeted manner through changes in individual transfers or a reduction in personal income taxation at low-income levels. The review of the reduced VAT rates announced by the German government in the 2011 stability programme has not been undertaken and is no longer part of the 2012 programme. There is also untapped potential for improving VAT collection and fighting VAT fraud in Germany, as available estimates indicate a higher collection gap than in the best-performing Member States[11].

There is also scope to reform or remove ineffective or inefficient subsidies via tax expenditures. Distributional policy objectives could be addressed more efficiently by a decreased income tax burden for relevant income groups, transfers to those not paying income tax or direct subsidies to suppliers. In particular, tax expenditure (such as energy tax reductions and exemptions, the taxation of company cars or the commuter income tax deduction) tend to undermine the effectiveness of environmental taxation and limit the scope for shifting the tax burden from labour to resource use. Cuts in energy tax allowances were

[9] Balanced budget rules have been enshrined in *Länder* constitutions by Hesse, Mecklenburg-Western Pomerania, Rhineland-Palatinate, Schleswig-Holstein and Lower Saxony and in budget laws by Baden-Württemberg, Bavaria, Hamburg, Saxony, Saxony-Anhalt and Thuringia.

[10] Bremen, Saarland, Berlin, Saxony-Anhalt and Schleswig-Holstein receive consolidation assistance.

[11] The VAT collection gap is estimated to be around 10 % of total theoretical VAT revenues in Germany in 2006, which is below the EU-25 average of 11 %, but significantly above the estimates for best performers (e.g. the Nordic countries and the Netherlands with gaps in the range of 3 %-5 %). (Reckon (2009), *Study to quantify and analyse the VAT gap in the EU-25 Member States*).

agreed for several sectors under the 2010 fiscal consolidation package, but further reducing tax expenditure in this area remains an issue. For example, the favourable income tax treatment for personal use of company cars (as compared to other labour income) encourages car use and can give rise to significant fiscal revenue losses[12]. There is further scope for reforming or reducing tax expenditure in the area of personal income taxation in particular[13].

Moreover, the efficiency of the German tax system could be improved by a shift towards property taxes, which do relatively less harm to growth. Revenues from taxes on property amounted to 0.85 % of GDP in Germany in 2010, far below the OECD average of 1.8 %[14]. Tax rate increases could be envisaged for the difficult-to-evade recurrent real estate tax (*Grundsteuer*) which is collected at the municipality level. Moreover, since the *Grundsteuer* is based on market values dating back to 1963/64 or even before, reassessing the taxable value on the basis of the rental value of the property could help reduce distortions.

3.2. Financial sector

The crisis revealed serious vulnerabilities in large parts of the financial sector. Since then, substantial public support measures in conjunction with the sector's own adjustment efforts and the rebound of the German economy appear to have stabilised the sector as a whole, although weaknesses remain in some areas. Although capitalisation has improved since the crisis, following the call by the European Council on 27 October 2011 for a temporary increase in banks' capital to 9 % Core Tier 1 capital ratio by mid-2012, in December 2011 the European Banking Authority (EBA) found that six banks needed to further increase their capital, and individual compliance plans are now being implemented. The six banks (Deutsche Bank, Commerzbank, Norddeutsche Landesbank, Landesbank Hessen-Thüringen, West LB, DZ Bank) need to raise a total of EUR 13.1 bn in capital. A decrease in the loan-to-deposit ratio since the crisis signals reduced dependence on volatile sources of funding; asset quality does not appear to be a problem at the aggregate level, as reflected in a low and decreasing non-performing loans ratio. Access to finance for the private sector (including SMEs) was not substantially restricted in 2008/09 and credit growth has picked up slightly since then, with no significant tightening of lending conditions in sight[15].

The authorities have taken further measures to safeguard the capitalisation and stability of the German financial system as a whole. Notably, the 2012 Second Financial Market Stabilisation Law has preventively and temporarily re-established the Financial Market Stabilisation Fund (*Soffin*) as a tool to provide capital and guarantees to weakened institutions. Further, the competences of the financial supervisor (*BaFin*) have been strengthened, enabling it to temporarily impose higher capital requirements on banks with a view to safeguarding financial stability. Also, according to draft legislation adopted by the government, a new Committee for Financial Stability (with voting members from the *Bundesbank*, the Ministry for Finance and *BaFin*) shall address recommendations to the relevant authorities, on the basis of analysis by the *Bundesbank*. Together with the 2011 Bank Restructuring Law, important steps have been taken to strengthen Germany's crisis prevention and management framework. Nevertheless, in line with lessons learned from the crisis, further measures (including the current international initiatives) may be needed in order to develop a more forward-looking macroprudential supervisory framework in Germany as well.

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12 FiFo estimates the additional revenue potential of abolishing the tax privilege for company cars at EUR 3.3 bn to EUR 5.5 bn (FiFo (2011), *Steuerliche Behandlung von Firmenwagen in Deutschland*, FiFo-Berichte Nr. 13).

13 See for example FiFo, Copenhagen Economics and ZEW (2009), *Evaluierung von Steuervergünstigungen*, Gutachten im Auftrag des Bundesministeriums der Finanzen.

14 OECD (2011), *Revenue Statistics*, OECD Publishing, 1965-2010.

15 See the ECB's April 2012 bank lending survey.

Despite the relatively benign picture overall in terms of macrofinancial stability, some risks remain. In particular, the structural problems of some *Landesbanken*, which were fully exposed in the crisis, remain an issue. These problems include the lack of a viable business model, weak governance structures and vulnerabilities due to a high degree of dependence on wholesale funding. There is progress insofar as capitalisation has improved and restructuring efforts are underway in the *Landesbanken* for which state aid cases are pending with the European Commission. Notably, WestLB will be liquidated, and what remains of it is to be incorporated into Helaba, another *Landesbank*. While a decision on the restructuring of Bayern LB is still outstanding, HSH Nordbank is to drastically shrink its balance sheet by reducing activities in certain areas. So although there has been progress in individual cases, Germany continues to address the *Landesbanken* issue through a piecemeal approach that lacks a comprehensive and long-term vision for the sector. The core problem of some *Landesbanken,* namely the design and implementation of a viable business model that will generate returns commensurate with the risks, remains unsolved. Reform efforts need to be pursued, and this would also help further reduce budgetary risks by ensuring the stability of *Landesbanken*, while also contributing to the efficiency of capital allocation in the economy. Restructuring options include reducing *Landesbanken* size (i.e. reducing them to their core business) and number (core services for the savings banks could be provided by a few institutions), as well as reviewing the need for public ownership with a view to strengthening governance and efficiency.

3.3. Labour market, education and social policy

In the medium and long term, ensuring the availability of a qualified labour supply will be crucial to mitigate the expected decline in potential growth. Currently, the performance of the German labour market remains strong, including among young people. The labour market's good performance is partly explained by the previous reforms, but some weaknesses remain which need to be addressed with a view to increasing employment and productivity, and ensuring that all labour market participants benefit from the positive developments in the labour market, including disadvantaged groups. Shortages of skilled workers are emerging in various sectors and regions. Activity and employment rates are high by international standards, but there is scope for further increasing participation and hours worked among certain groups, and more skilled workers from abroad could contribute to closing the remaining gap. These challenges were reflected in last year's country specific recommendations and have also been highlighted in the annual growth survey 2012. The German government acknowledges these challenges in the national reform programme, which sets a target of a 77 % employment rate for both women and men in the 20-64 age bracket by 2020. The national reform programme refers to the Plan to secure skilled labour (*Konzept Fachkräftesicherung*) from June 2011 and describes a number of measures to increase labour market participation and improve education, including a strategy on demographic change (*Demografiestrategie*) to be published in spring 2012.

A major concern is the low share of women working full-time. The high incidence of part-time work among women, together with other factors such as the different professional and sectoral choices made by men and women and differences in work patterns, contributes to a high gender pay gap in Germany. Second earners face significant fiscal disincentives in Germany due to the joint taxation of income for married couples (*Ehegattensplitting*) in the progressive tax system. The impact of an option to modify the allocation of the wage tax deduction between spouses (*Faktorverfahren*), introduced in 2009, has not yet been assessed by the German authorities, but it is likely to be limited, because the yearly tax burden remains unchanged. The joint income taxation system also results in substantially lower tax revenues compared with a system of individual income taxation[16]. Moreover, the free health-insurance coverage for non-working spouses discourages them from taking up a job or increasing their working hours. Although the Plan to secure skilled labour identifies women as the group with the highest potential to increase labour force participation, it does not contain any measures to tackle fiscal disincentives for second earners. Germany intends to carry out an overall evaluation of the system of taxation and social benefits related to marriage and family, but only in 2013.

The lack of all-day childcare facilities and schools also hinders labour market participation, and especially discourages women with children from working full time. Against this background, the national reform programme confirms that the federal and *Länder* governments are committed to providing childcare facilities for at least 35 % of children below the age of three by 2013 and to granting the legal right to childcare for children between one and three years old as of August 2013. These commitments are relevant, but progress is still insufficient and all the relevant levels of government need to step up their efforts, notably in the western *Länder*. In addition to providing sufficient places, the introduction of longer and more flexible care hours in childcare facilities and longer schooldays would allow parents to better reconcile family and work life. In the future, more ambitious targets regarding childcare facilities may be required in order to achieve a significantly higher share of full-time female labour participation. Moreover, the national reform programme announces the introduction of a childcare allowance (*Betreuungsgeld*). If the allowance is given to families with children under three who do not make use of formal childcare facilities, as currently discussed, it would risk creating an additional disincentive to work for parents with children, running counter to the objective of increasing female labour participation. There would also be a risk that more children, especially from disadvantaged, low-income families, would not participate in high-quality early childhood education and care.

The German labour market's good performance has not benefited all participants to the same extent and there is scope for improving the integration of certain groups[17]. Fiscal disincentives arising from the high tax wedge — in particular the relatively high social contributions — continue to hinder the integration of *low-wage earners* in particular into the labour market. The tax wedge for workers earning 67 % of the average wage is the third highest in the EU (single person without children, data for 2010), in particular due to the relatively high social security contributions, and inactivity and unemployment traps are also relatively high in Germany. The integration of *low-skilled workers* is rendered difficult by the fact that their qualifications often do not match the skills required. The employment rates of *older workers* have increased significantly following labour market and pension reforms, but there is scope for further raising the effective retirement age. While long-term unemployment markedly decreased following the labour market reforms, integrating the remaining *long-term unemployed* into the labour market is increasingly difficult. There is also room for improvement regarding *people with a migration background*, since their employment and unemployment rates are substantially worse than those of the rest of the population.

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16 The introduction of an individual income taxation system would increase married women's labour participation and would generate additional tax revenues of around EUR 27 bn, according to Bach, S., Geyer, J., Haan, P. and Wrohlich, K. (2011): *Reform des Ehegattensplittings: Nur eine reine Individualbesteuerung erhöht die Erwerbsanreize deutlich*, DIW Wochenbericht 4/2011.

17 There are overlaps among the groups described, as the unemployed often face several constraints simultaneously. For instance, according to the Federal Labour Agency, almost half of the long-term unemployed have had no vocational education and 40 % of them are 50 years old or older (*Bundesagentur für Arbeit* (2011): *Sockel- und Langzeitarbeitslosigkeit*). The probability of finding a job is lower for the long-term unemployed who face additional constraints.

The national reform programme describes a number of measures geared to facilitating labour market integration. Regarding the 2011 recommendation on reducing fiscal disincentives to work, the reduction in the pension contribution rate by 0.3 pps in 2012, partly offset by the planned increase in the long-term care contribution rate by 0.1 pps as from 2013, will only slightly reduce the tax wedge. If adopted, the proposed income tax reform aimed at reducing fiscal drag would also reduce the tax wedge to a certain extent. The 2011 health care reform allowed insurers to raise flat-rate contributions to cover cost increases, combined with compensation for low-income earners through the tax system. In principle, this could pave the way for decoupling health care and labour costs, thus potentially promoting employment. However, this option has not been used so far due to insurers' favourable financial situation, which is partly the result of the increase in the contribution rate of 0.6 pps in 2011, bringing it up to the pre-crisis level of 15.5 %. Furthermore, Germany has slightly increased the income allowance in unemployment benefits in order to facilitate the integration of the unemployed into the labour market; its impact is likely to be limited. In addition, following the 2010 fiscal consolidation package which substantially reduced resources allocated to active labour market policies, also because of the expected cyclical improvement in the labour market, Germany adopted new legislation in autumn 2011 aimed at improving the efficiency of active labour market instruments. It is important to continue improving these instruments and ensuring that reforms are geared towards making the most of the existing labour potential (see paragraph below on social policies).

The Plan to secure skilled labour recognises that mobilising domestic labour potential will not be sufficient to compensate for the impact of the declining population on labour supply, and attracting skilled labour from abroad could contribute to closing the gap. Germany is taking some steps in the right direction. A law aimed at facilitating the recognition of professional qualifications obtained abroad entered into force in April, and the government has published a draft law aimed at facilitating the immigration of skilled workers from outside the EU ('blue card'). Moreover, a National Action Plan for Integration was agreed in January.

With a view to increasing labour force participation and productivity in the medium and long term, Germany would benefit from further raising the performance of the education system. Regarding childcare, in addition to the efforts to increase the availability of childcare facilities, there is also scope for improving the qualifications of childcare staff, which are low by international standards, possibly by upgrading their training to tertiary level[18]. Providing high-quality childcare is crucial, in particular for children from disadvantaged families, given the high correlation between early childhood education and subsequent educational performance. The country is not far from achieving its national target of reducing early school leaving to less than 10 % by 2020 (11.9 % in 2010), but progress is slow and the rate for people with a migration background is significantly worse (23.4 %). Implementation of the measures included in the extended National Training Pact (*Ausbildungspakt*) should alleviate some shortcomings in the so-called *Übergangssystem*, aiming at supporting the transition from lower-secondary education to (dual) vocational and educational training. The well-developed system of vocational education and training (VET, *Berufsausbildung*) is traditionally seen as key in delivering a skilled workforce and contributing to low youth unemployment. However, the type of skills developed by the VET system are not always the same as those developed by tertiary education, such as the ability to adapt to the labour market needs of a fast-changing economic environment[19]. Over the next few years, the current

[18] Educators in the early childhood education and care sector in Germany have the lowest level of training in Western Europe except for Austria (OECD (2008), *Economic survey of Germany: 2008*).

[19] The tertiary attainment rate (ISCED levels 5 and 6) in Germany is below the EU average (29.8 % in Germany compared with an EU average of 33.6 %) and has increased only slowly in the past (by 4.1 pps since 2000 in Germany, whereas on EU average it increased by 11.2 pps). However, in its national

heavy influx of young people into tertiary education is expected to continue. The government has already reacted to this by increasing the number of available places and improving the quality of provision. Moreover, there is scope for improving adult participation in lifelong learning, and given the high number of functional adult illiterates, it is important to implement the 2011 national strategy for literacy and basic education. Raising the education performance of socially disadvantaged groups would also contribute to higher labour force participation (see following paragraph on social policies).

The reforms of recent years have had a positive impact on the functioning of the labour market and have created additional incentives to work; however, they may have had knock-on effects on the welfare of some groups, possibly contributing to rising income inequalities. For instance, while helping to reduce the number of long-term unemployed, the *Hartz* reforms led to a reduction in benefit levels for some long-term unemployed. Germany linked its poverty reduction target directly to the number of long-term unemployed[20]. Integrating the remaining long-term unemployed into the labour market is increasingly difficult, and it is important to ensure that the recent reform of labour market instruments, which includes cuts in the federal funding of activation and integration programmes and instruments for the long-term unemployed, does not result in their employment opportunities deteriorating.

Moreover, the broader use of non-standard contracts, such as part-time (including so-called ‘mini-jobs’), fixed-term or temporary agency work, has increased flexibility in the labour market and employment. But this has also contributed to growing inequalities among workers, as wages in these jobs are often lower than in regular full-time jobs, and in the case of ‘mini-jobs’, acquired pension rights are very low. The in-work poverty rate reached 7.2 % in 2010 and for temporary workers and single parents exceeds the respective EU averages. The poverty rate of adults in very low work intensity households is around 70 %. The introduction of a general minimum wage is currently being discussed in Germany. It is important that any mechanism for determining the level and scope of a minimum wage takes into account its potential impact on employment and the existing differences in labour market and economic conditions across regions.

Raising the educational achievement levels of disadvantaged groups remains a major challenge for Germany. The strong link between educational achievement and socio-economic background reflects the stratification of the education and training system. Some *Länder* have reduced the number of school streams and postponed separating pupils into paths until they are older. If accompanied by appropriate support measures, this can have a positive impact on equal educational opportunities. Pedagogical measures (e.g. early language learning) implemented during the past few years are expected to contribute to further raising the performance of groups at risk. Tackling educational disadvantage is also a key component of the National Action Plan for Integration agreed in January 2012. In short, Germany needs to speed up its efforts to improve educational outcomes, in particular among socially disadvantaged groups.

Germany is making some progress in increasing the number of childcare facilities and in tackling educational disadvantage, but changes in the pension and long-term care contribution rates will only have a minor impact on the tax wedge, and fiscal disincentives for second earners remain. The national reform strategy acknowledges the need to enhance labour participation among the groups with the highest potential and proposes a number of relevant

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2020 attainment target (42 %), Germany also includes post-secondary non-tertiary education and training qualifications (ISCED level 4), and has thus already reached the target (41.6 %).

20 The German target for the reduction in the number of people at risk of poverty or social exclusion is a 20 % reduction in the number of long-term unemployed by 2020 compared with 2008, i.e. reduction by 320 000 long-term unemployed. After data revision, Germany recently reduced this figure by 10 000.

measures. It is important to implement these measures effectively, monitor their impact and adapt or complement them if necessary. However, some measures proposed lack ambition or even run counter to the objective of increasing female labour supply, despite women being identified as the group with the highest potential in the Plan to secure skilled labour. This holds in particular for the proposed childcare allowance and the absence of concrete measures to reduce fiscal disincentives for second earners.

3.4. Structural measures promoting growth and competitiveness

If properly designed, structural reforms help increase productivity by enhancing competitiveness and economic efficiency. In a context of fiscal consolidation, particular attention should be paid to the design of such reforms in order to ensure that goals are achieved at the lowest possible cost.

Internal market, liberalisation and competition

Despite noticeable progress in recent years, *inter alia* through the implementation of the Services Directive, there is scope for further stimulating competition and productivity growth in some services sectors. This could include examining the justification and proportionality of shareholding and legal form requirements for regulated professions, as well as the authorisations applied to incoming service providers. The requirement to hold a master craftsman's certificate (*Meisterbrief*) or an equivalent qualification in order to run a craft business, as described in the national reform programme, remains in large parts of the craft sectors, including in the construction sector. This complicates the entry of small businesses in particular. Importantly, in response to the corresponding 2011 country specific recommendation, the national reform programme announces that the question of whether entry and conduct regulation in the services sectors can be further reduced without any negative impact on quality and safety will be assessed. In addition, the government has proposed revising the Act against Competition Restrictions and has adopted a revision of the Telecommunications Act. Effective implementation of these measures should help increase competition. Moreover, the government intends to review the competition framework in the postal sector. The postal mail market is still dominated by the incumbent operator and competition remains limited. It is important that the revision is not delayed and that it should give the regulator additional instruments, notably concerning price control. Moreover, with a view to reducing distortions in competition and the burden on public finances, Germany could strengthen its institutional set-up to ensure effective control over state aid.

Competition in the passenger and freight rail markets remains very limited, mainly due to the lack of effective separation between the infrastructure manager and the railway holding. This has an impact on the whole European railway system, given Germany's central geographical position. The national reform programme announces new legislation that will strengthen the powers of the regulator over the railway sector, as requested in a 2011 country specific recommendation, and a new law to partially open up the long-distance bus market, but neither text has yet been adopted. These measures are relevant, but they do not go far enough to substantially increase competition in the transport sector. In particular, the new railway legislation will not address the separation between the infrastructure manager and the railway holding, which is the main barrier to competition in the railway sector. Moreover, the timely deployment of the European-wide rail signalling system ERTMS would also stimulate competition in the transport sector by facilitating cross-border rail traffic.

Energy and environment

Acknowledging the long-term challenges of energy provision, Germany is pursuing a major reform of the energy system (see Box 2). The new energy strategy creates new opportunities for growth, but it also entails significant challenges in terms of the potentially high overall economic costs and the risk of the system being vulnerable due to capacity constraints.

Box 2. The German energy strategy

Germany's new energy strategy aims to provide a timely response to the long-term challenges of energy provision, namely the expected steep increase in energy prices as a consequence of the world's rising demand for energy, the dependence on energy imports, and the need to reduce greenhouse gas emissions. The strategy is ambitious as it aims to ensure competitive energy prices, a high level of energy security, and effective climate protection.

The main features of the energy strategy were set out in the Energy Concept (*Energiekonzept*), adopted in September 2010, which fixed ambitious climate and energy targets. Renewable energy sources should account for the biggest share in the energy mix by 2050, with nuclear energy playing a bridging role. In 2010 it was decided to extend the operating lives of the 17 German nuclear power plants by an average of 12 years.

Following the Fukushima nuclear disaster in March 2011, the government decided to implement the *Energiewende* ('energy turnaround') to accelerate the transformation of the energy system. Eight nuclear power plants have been shut down and the remainder should be phased out by 2022, reversing the 2010 decision to prolong the operating lives of nuclear plants.

In summer 2011, the government presented a package of eight laws (*Energiepaket*) to implement the *Energiewende* and *Energiekonzept*. The Energy Package includes a revision of the Renewable Energy Act (*Erneubare-Energien-Gesetz, EEG*) aimed at improving the cost-effectiveness of the system to promote renewable energy and making it more market-oriented. The special compensation scheme to relieve the burden of higher electricity costs on energy-intensive industries is made more generous. The Energy Package also includes a Grid Expansion Acceleration Act to speed up the expansion and upgrading of the grid, and a revision of the Energy Industry Act which implements the EU Third Energy Package, including the provision for 10-year network development plans. All laws have entered into force except for the Act to promote the renovation of buildings through taxation.

In order to minimise the overall economic costs of the new energy strategy, it is crucial to improve the cost-effectiveness of the system to promote renewable energy. In line with the corresponding 2011 country specific recommendations, the revised Renewable Energy Act addresses this through measures to improve the market and system integration of renewables and larger feed-in tariff reductions for specific technologies. Moreover, the government has recently adopted further measures to control the costs of promoting solar energy. These steps go in the right direction, but it is important to continue efforts to further improve the cost-effectiveness of the renewables policy. In order to avoid overcompensation, it is necessary to continue to adjust the feed-in tariffs for new capacities in line with cost developments. The new market premium option may help integrate renewables into the market. However, the special compensation scheme for energy-intensive industries and the exemption from network fees for companies with very high electricity consumption both add to the electricity bill of other industrial consumers and households, and tend to distort price signals. It is important to ensure that instruments designed to keep industry competitive do not weaken the cost-effectiveness of the whole system. In this regard, it may be advisable to explore more efficient ways of alleviating the impact of higher energy costs on industry, including measures aimed at increasing their energy efficiency.

The Energy Concept and the national reform programme both recognise the important challenges of expanding and upgrading the grid and providing additional storage and flexible generation capacities, which are pre-requisites for the expansion of renewables. Regarding electricity, it is essential to expand the north-south axis and the cross-border interconnections, in particular given the reduced back-up capacity in the south of Germany due to the shutdown of nuclear power plants, and the increase in renewable capacities in the North and Baltic Seas. However, the lack of public acceptance and insufficient coordination among regional authorities hinders progress in expanding the electricity grid. Therefore, it is important to ensure that the new Grid Acceleration Act is implemented effectively in coordination with the EU-wide 10-year network development plan, to better integrate onshore and offshore planning and to merge the spatial planning and plan approval procedures at federal level. Moreover, enhanced north-south gas transport capacity and further integrating the German gas market with its neighbours in Central Europe would improve the availability of gas capacities, for the back-up of renewables energies and security of both gas and electricity supply.

The Energy Concept sets ambitious targets regarding energy efficiency. Increasing energy efficiency is particularly important, as it contributes to achieving the climate and renewable energy targets while reducing energy costs. Thus, the existing scope for increasing energy efficiency needs to be exploited, in particular by introducing adequate legal instruments in the building sector.

Germany transposed the EU Third Energy Package in 2011. This would generate more competition in the electricity and gas markets, in line with the corresponding 2011 country specific recommendations.

Germany has committed itself to reducing its greenhouse gas (GHG) emissions in sectors outside the Emissions Trading System (non-ETS sectors) by 14 % by 2020 compared with 2005. Until 2010, GHG emissions had fallen by 6 % compared with 2005. There may be scope to improve the consistency of the climate policy framework, for example by reducing relevant tax expenditure, which would improve the effectiveness of environmental taxation (see section on the tax system). By allocating all revenue from auctioning allowances in the ETS to the Energy and Climate Fund, Germany has gone beyond its obligation under the ETS Directive to allocate at least 50 % of auctioning revenue to climate change measures.

Research and innovation

Germany is one of the innovation leaders in the EU according to the Innovation Union Scoreboard and is already close to achieving its R&D expenditure target of 3 % of GDP. However, other economies and innovation leaders are investing even more in research and innovation. Significantly, the 2012 German Action Programme for the Euro Plus Pact announces measures intended to promote the venture capital market, which is still relatively underdeveloped, as well as ‘business angels’. Moreover, adapting the educational system and the labour market to the changing requirements of technology and innovation will be crucial for preserving Germany’s innovative power and competitiveness in the long term.

Regarding the 2011 recommendation relating to services and network industries, most improvements have been made in the area of energy, but the new energy strategy still poses some major challenges which need to be tackled. Progress in removing regulatory restrictions and stimulating competition in the railway sector and other services sectors has been limited.

3.5. Modernisation of public administration

According to the World Bank's *Doing Business 2012* report, Germany generally has a business-friendly regulatory environment, but there may be scope for further improvement or simplification in certain areas of regulation, for example regarding business start-up and licensing procedures, the protection of investors or the registration of property.

Germany has made noticeable progress in recent years in reducing the administrative burden related to reporting obligations in the business sector. The federal government agreed in December 2011 to introduce a number of additional simplification measures, such as the reduction of the minimum archiving period for invoices and documents. Furthermore, the Bureaucracy Reduction and Better Regulation Programme was extended in 2011 to cover not just reporting obligations but also other measurable compliance costs. The National Regulatory Control Council (*Nationaler Normenkontrollrat*) now scrutinises the administrative burden and compliance costs of all new regulatory proposals for businesses, citizens and public administrations. The 2011 Tax Simplification Act also introduced some further improvements and simplifications, for example regarding electronic invoicing. Nevertheless, it is important to continue along this route and to stay ambitious about further reducing compliance costs and the administrative burden for enterprises, especially SMEs.

Germany has also made progress in recent years in reducing both the cost and time involved in business start-up and licensing procedures; however, further progress will be necessary in order to fully meet the objectives endorsed by the Council in 2011. Furthermore, while the online availability of basic public services appears satisfactory, e-government services in Germany are still relatively little used by small enterprises. This may suggest further scope for promoting existing e-government services and for improving their functionality. Points of Single Contact are established in all *Länder*, but some are more developed than others in terms of procedures or the information they provide. It is important that they should all play their role in helping to improve the availability of online procedures.

4. OVERVIEW TABLE

2011 commitments	Summary assessment
Country-specific recommendations (CSRs)	
Implement the budgetary strategy for the year 2012 and beyond as envisaged, thus bringing the high public debt ratio on a downward path, in line with the Council recommendations under the EDP. Ensure an adequate structural adjustment effort towards the medium-term objective thereafter. Complete the implementation of the budgetary rule at the *Länder* level and further strengthen the corresponding monitoring and sanctioning mechanism. Maintain a growth-friendly consolidation course, in particular by safeguarding adequate expenditure on education and by further enhancing the efficiency of public spending on health-care and long-term care.	Germany has partially implemented the CSR. Germany brought the deficit below the 3% of GDP reference value in 2011, thus two years ahead of the deadline set by the Council. It plans to meet its medium-term budgetary objective already in 2012 and to reach virtually balanced nominal budgets as from 2014. The implementation of the debt break at the *Länder* level remains incomplete and inconsistent across *Länder*. The effectiveness of the monitoring of fiscal developments through the Stability Council may be weakened by inadequate monitoring indicators. The federal government is well on track to meet its commitment to increase its spending on education and research. However, it is important that commitments are met by all levels of government. The latest health care reform has led to some cost reductions, especially for pharmaceuticals, though further efforts are required to contain expenditure increases in the future. Furthermore, the federal government adopted a reform of long-term care aiming to extend benefits, to increase the contribution rate by 0.1pp and to introduce tax incentives for voluntary private insurance, which also appears insufficient to cope with expected future cost increases, however.
Address the structural weaknesses in the financial sector, in particular by restructuring *Landesbanken* which are in need of an adequately funded viable business model.	Germany has partially implemented the CSR. Germany has taken measures to safeguard the adequate capitalisation and stability of the German financial system, but further measures (including the current international initiatives) may be needed in order to develop a more forward-looking macroprudential supervisory framework. Regarding the *Landesbanken*, there has been progress in individual cases. However, Germany is following a piecemeal approach that lacks a comprehensive and long-term vision for the sector, and the core problem of some *Landesbanken*, namely the lack of a viable business model, remains unsolved.
Enhance participation in the labour market by improving equitable access to education and training systems and by taking further steps to reduce the high tax wedge in a budgetary neutral way and improve work incentives for persons with low income perspectives. Increase the number of fulltime childcare facilities and all-day schools. Closely monitor the effects of recent reform measures to reduce tax disincentives for second earners and take further measures in case disincentives remain.	Germany has partially implemented the CSR. Germany is making some progress in tackling educational disadvantage. Some *Länder* have taken measures which may have a positive impact on equal education opportunities. Pedagogical measures (e.g. early language learning) are expected to improve the performance of groups at risk. Implementation of the measures included in the extended National Training Pact (*Ausbildungspakt*) should alleviate some shortcomings in the so-called *Übergangssystem*, aiming at supporting the transition from lower-secondary education to (dual) vocational and

	educational training. Changes in the pension and long-term care contribution rates will only have a minor impact on the tax wedge, which remains high. It is important to ensure that the reduction of resources allocated to activation and integration programmes and instruments does not result in worsening employment opportunities for the unemployed. The impact of the increase in the income allowance in unemployment benefits is likely to be limited. Progress in increasing the number of childcare facilities is slow. The national reform programme does not provide information on progress regarding the introduction of all-day childcare facilities and schools. Germany has not reported on the effects of previous reform measures to reduce tax disincentives for second earners, but the impact of the 2009 reform on the joint income taxation system (*Faktorverfahren*) is likely to be limited. The plan to carry out an evaluation of the system of taxation and social benefits related to marriage and family in 2013 is welcome, but this is an important issue that deserves more ambitious treatment. Moreover, the introduction of a childcare allowance would risk creating an additional disincentive to work for parents with children.
Remove unjustified restrictions on certain professional services and on certain crafts. To improve competition in network industries, strengthen the supervisory role of the Federal Network Agency in the rail sector; and, in the context of the announced national Energy Concept, focus on improving the long-term cost-effectiveness of the Renewable Energy Act, ensuring the effective independence of energy production and transmission, and improving cross- border interconnections.	Germany has partially implemented the CSR. Progress in stimulating competition in the services sectors has been limited. The new legislation on the railway sector will not address the separation between the infrastructure manager and the railway holding, which is the main barrier to competition in the railway sector. Germany is making progress in improving the long-term cost-effectiveness of renewable energy, but it is important to continue efforts in this regard, in particular given the ambitious new energy strategy. Germany transposed the EU Third Energy Package in 2011. Progress in expanding the electricity grid is hindered by a lack of public acceptance and by the insufficient coordination among regional authorities. Bottlenecks remain in gas transport capacity.
Euro Plus Pact (national commitments and progress)	
Enhance the sustainability of public finances, by achieving the deficit target earlier than required and exceeding the targets set in the debt rule.	Germany has fully implemented the commitments. Germany brought the deficit below the 3% of GDP reference value in 2011, thus two years ahead of the deadline set by the Council. The federal government also exceeded the targets set by the national debt rule.
Foster employment, by promoting science and research, tackling literacy problems among adults, reforming labour market policy instruments, making it easier to combine work with care commitments, and facilitating voluntary service.	Germany has partially implemented the commitments. Most of these measures were planned, and some were being implemented already before being included in the Euro Plus Pact in 2011 and did not represent additional commitments. It is important to ensure that the reduction of

	resources allocated to activation and integration programmes and instruments does not results in worsening employment opportunities for the unemployed.
Foster competitiveness, by promoting innovation, facilitating the integration of skilled professionals with foreign qualifications and migrants, promoting excellence at universities, continuing to expand and improve the quality of childcare facilities, and promoting integration through language training among children. Foster competitiveness, by increasing funding for the development and maintenance of federal transport infrastructure, expanding broadband infrastructure, promoting innovation in the field of electric mobility, boosting competition in the electricity and gas markets, speeding up the extension of the electricity network, developing a new research energy programme, further liberalising protected sectors, including the long-distance bus transport market, and promoting competition.	Germany has partially implemented the commitments. Most of these measures were planned, and some were being implemented already before being included in the Euro Plus Pact in 2011 and did not represent additional commitments. It is important to ensure effective implementation of the new legislation. Progress in expanding and improving the quality of childcare facilities is slow.
Reinforce financial stability, by increasing the efficiency of the regulation and supervision of the capital market and ensuring that the banking sector assumes some of the cost of public sector assistance.	Germany has partially implemented the commitments. Both measures have been introduced, but further measures (including the current international initiatives) may be needed to develop a more forward-looking macroprudential supervisory framework, and monitoring the effectiveness of the new restructuring fund may be needed.
Europe 2020 (national targets and progress)	
Employment rate: 77 %	Employment rate: 74.9 % in 2010.
R&D target: 3 % of GDP	Gross domestic R&D expenditure: 2.82 % in 2010.
Greenhouse gas (GHG) emissions target: -14 % (compared with 2005; emissions in sectors within the Emissions Trading System (ETS) are not covered by this target)	Change in non-ETS GHG emissions between 2005 and 2010: -6% (this data corresponds to the current ETS scope).
Renewable energy target: 18 % of renewable energy in gross final energy consumption	Share of renewable energy in gross final energy consumption: 9.8 % in 2009 (Eurostat) and 11.3 % (National RES Progress report). Germany has already achieved its 2011/2012 interim renewable energy target.
Energy efficiency — reduction in primary energy consumption by 2020 (in Mtoe): 38.30 Mtoe	NA The energy efficiency objectives are set according to national circumstances and national formulations. As the methodology for expressing the 2020 energy consumption impact of these objectives in the same format was agreed only recently, the Commission is not yet able to give an overview.
Early school leaving target: < 10 %	Early leavers from education and training (percentage of the population aged 18-24 with at most lower secondary education and not in further education or training): 11.9 % in 2010. Significant achievement gap between migrants and natives (23.4 % vs. 10.2 %).
Tertiary (or equivalent) education target: 42 %	Tertiary educational attainment: 29.8 % in 2010 on the

(Germany also includes qualifications in its national attainment target that it considers as 'equivalent' to tertiary attainment, technically classified at ISCED 4 levels).	basis of ISCED 5 and 6. Including the additional qualifications included by Germany in its national target, the performance in 2010 was 41.3 %.
Target for the reduction in the number of people at risk of poverty or social exclusion: 20% reduction in the number of long-term unemployed by 2020 compared with 2008, i.e. reduction by 320 000 long-term unemployed	People at risk of poverty or social exclusion: 19.7 % of the population in 2010, i.e. 15.9 million people. Target: 15% reduction in the number of long-term unemployed compared with 2008, i.e. reduction by 240 000 long-term unemployed.

5. ANNEX

Table I. Macro-economic indicators

	1995-1999	2000-2004	2005-2008	2009	2010	2011	2012	2013
Core indicators								
GDP growth rate	1.6	1.1	2.2	-5.1	3.7	3.0	0.7	1.7
Output gap [1]	-0.3	-0.1	0.6	-3.8	-1.4	0.0	-0.9	-0.8
HICP (annual % change)	1.0	1.5	2.2	0.2	1.2	2.5	2.3	1.8
Domestic demand (annual % change) [2]	1.6	0.1	1.4	-2.6	2.4	2.3	1.0	2.0
Unemployment rate (% of labour force) [3]	9.0	9.0	9.5	7.8	7.1	5.9	5.5	5.3
Gross fixed capital formation (% of GDP)	21.3	19.0	18.1	17.2	17.5	18.2	18.4	18.8
Gross national saving (% of GDP)	20.9	20.6	24.8	22.3	23.1	23.2	22.6	22.9
General government (% of GDP)								
Net lending (+) or net borrowing (-)	**-3.9**	**-2.7**	**-1.2**	**-3.2**	**-4.3**	**-1.0**	**-0.9**	**-0.7**
Gross debt	**59.1**	**62.2**	**67.1**	**74.4**	**83.0**	**81.2**	**82.2**	**80.7**
Net financial assets	**-32.3**	**-40.1**	**-46.1**	**-49.1**	**-50.1**	**n.a**	**n.a**	**n.a**
Total revenue	45.8	44.5	43.8	44.9	43.6	44.7	44.7	44.4
Total expenditure	49.7	47.2	44.9	48.1	47.9	45.7	45.6	45.2
of which: Interest	3.4	3.0	2.8	2.7	2.5	2.7	2.6	2.4
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-0.3**	**-0.9**	**1.6**	**2.6**	**4.0**	**0.9**	**0.2**	**0.2**
Net financial assets, non-financial corporations	**-52.0**	**-52.8**	**-56.8**	**-51.9**	**-59.3**	**n.a**	**n.a**	**n.a**
Net financial assets, financial corporations	**-1.4**	**-6.8**	**-4.0**	**-3.3**	**4.5**	**n.a**	**n.a**	**n.a**
Gross capital formation	11.5	11.2	11.1	8.9	9.7	10.0	9.9	10.3
Gross operating surplus	21.1	22.3	25.3	23.0	24.5	24.1	23.5	23.9
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**3.3**	**5.0**	**5.9**	**6.4**	**6.0**	**5.4**	**5.3**	**5.1**
Net financial assets	**86.9**	**100.9**	**116.2**	**123.2**	**125.9**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	43.6	43.1	40.5	42.1	41.5	41.8	42.5	42.4
Net property income	11.0	12.0	14.0	14.2	13.8	14.5	14.7	14.7
Current transfers received	22.5	23.0	21.7	22.9	22.2	21.1	20.9	20.6
Gross saving	11.0	10.8	11.5	12.0	11.8	11.5	11.6	11.5
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-0.9**	**1.4**	**6.3**	**5.8**	**5.8**	**5.3**	**4.7**	**4.5**
Net financial assets	**-0.5**	**0.7**	**-6.9**	**-15.4**	**-16.2**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	1.0	3.2	6.0	5.0	5.5	5.1	4.5	4.3
Net primary income from the rest of the world	-0.9	-0.7	1.5	2.1	1.9	1.6	1.7	1.7
Net capital transactions	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Tradable sector	41.5	41.7	42.1	39.0	40.0	40.8	n.a	n.a
Non-tradable sector	48.9	48.4	47.8	50.2	49.5	48.5	n.a	n.a
of which: Building and construction sector	5.6	4.2	3.7	4.0	3.9	3.9	n.a	n.a
Real effective exchange rate (index, 2000=100)	114.7	100.6	96.8	98.3	94.2	94.7	94.4	94.6
Terms of trade in goods and services (index, 2000=100)	103.8	101.8	100.3	102.8	100.7	98.3	97.5	97.7
Market performance of exports (index, 2000=100)	100.2	105.0	114.7	117.4	121.1	126.2	128.5	129.9

Notes:

[1] The output gap constitutes the gap between actual and potential gross domestic product at 2000 market prices.

[2] The indicator for domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source :

Commission spring 2012 forecast

Table II. Comparison of macroeconomic developments and forecasts

	2011		2012		2013		2014	2015	2016
	COM	SP	COM	SP	COM	SP	SP	SP	SP
Real GDP (% change)	3.0	3.0	0.7	0.7	1.7	1.6	1½	1½	1½
Private consumption (% change)	1.5	1.5	0.9	1.2	1.2	1.4	1½	1½	1½
Gross fixed capital formation (% change)	6.4	6.4	2.1	1.5	4.7	3.6	3.0	3.0	3.0
Exports of goods and services (% change)	8.2	8.2	2.9	2.0	5.0	4.3	4½	4½	4½
Imports of goods and services (% change)	7.4	7.4	3.8	3.0	6.0	4.8	5.0	5.0	5.0
Contributions to real GDP growth:									
- Final domestic demand	2.2	2.2	1.2	1.2	1.9	1.7	1½	1½	1½
- Change in inventories	0.0	0.0	-0.2	-0.1	0.0	n.a.	0.0	0.0	0.0
- Net exports	0.8	0.8	-0.3	-0.3	-0.2	0.0	0.0	0.0	0.0
Output gap[1]	0.0	0.1	-0.9	-0.9	-0.8	-0.9	-0.6	-0.2	0.1
Employment (% change)	1.3	1.3	1.0	0.5	0.4	0.2	0.0	0.0	0.0
Unemployment rate (%)	5.9	5.8	5.5	5.4	5.3	5.2	5.0	5.0	5.0
Labour productivity (% change)	1.6	1.6	-0.4	0.1	1.3	1.4	1½	1½	1½
HICP inflation (%)	2.5	n.a.	2.3	n.a.	1.8	n.a.	n.a.	n.a.	n.a.
GDP deflator (% change)	0.8	0.8	1.6	1.5	1.8	1.3	1¼	1¼	1¼
Comp. of employees (per head, % change)	3.0	3.0	2.7	1.9	2.8	2.1	2½	2½	2½
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	5.3	5.3	4.7	4.8	4.5	4.5	4¼	4¼	4¼

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by the Commission.

Source:

Commission spring 2012 forecasts (COM); Stability programme (SP).

Table III. Composition of the budgetary adjustment

(% of GDP)	2011	2012		2013		2014	2015	2016	Change: 2011-2016
	COM	**COM**	**SP**	**COM**	**SP**	**SP**	**SP**	**SP**	**SP**
Revenue	**44.7**	**44.7**	**45.0**	**44.4**	**44½**	**44½**	**44½**	**44½**	**-0.2**
of which:									
- Taxes on production and imports	11.4	11.4	11½	11.3	11½	11½	11.0	11.0	-0.3
- Current taxes on income, wealth, etc.	11.5	11.7	12.0	11.8	12.0	12.0	12½	12½	1.1
- Social contributions	16.9	17.0	17.0	16.7	16½	16½	16½	16½	-0.3
- Other (residual)	4.9	4.7	4.6	4.6	4.6	4.4	4.4	4.2	-0.7
Expenditure	**45.7**	**45.6**	**46.0**	**45.2**	**45½**	**44½**	**44½**	**44½**	**-1.3**
of which:									
- Primary expenditure	43.0	43.0	43.1	42.8	42.7	42.1	42.0	41.8	-1.2
of which:									
Compensation of employees and	7.8	7.8	8.0	7.7	7½	7½	7½	7½	-0.4
intermediate consumption	5.0	5.1	5.0	5.2	5.0	5.0	4½	4½	-0.3
Social payments	24.5	24.5	24½	24.3	24½	24½	24½	24½	-0.2
Subsidies	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	-0.1
Gross fixed capital formation	1.6	1.5	1½	1.5	1½	1½	1½	1½	-0.1
Other (residual)	3.1	3.1	3.0	3.1	3.0	3.0	3.0	3.0	-0.1
- Interest expenditure	2.7	2.6	2½	2.4	2½	2½	2½	2½	-0.1
General government balance (GGB)	**-1.0**	**-0.9**	**-1.0**	**-0.7**	**-½**	**0.0**	**0.0**	**0.0**	**1.2**
Primary balance	**1.6**	**1.7**	**1½**	**1.6**	**2.0**	**2½**	**2½**	**3.0**	**1.2**
One-off and other temporary measures	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2
GGB excl. one-offs	**-0.8**	**-0.9**	**-0.9**	**-0.7**	**-0.7**	**-0.2**	**0.0**	**0.2**	**1.0**
Output gap[2]	0.0	-0.9	-0.9	-0.8	-0.9	-0.6	-0.2	0.1	0.1
Cyclically adjusted balance[2]	-1.0	-0.4	-0.5	-0.3	-0.3	0.1	0.1	0.1	1.2
Structural balance[3]	**-0.8**	**-0.4**	**-0.5**	**-0.3**	**-0.3**	**0.1**	**0.1**	**0.1**	**1.0**
Change in structural balance		*0.4*	*0.4*	*0.1*	*0.2*	*0.3*	*0.0*	*0.0*	
Structural primary balance[3]	**1.8**	**2.1**	**2.2**	**2.0**	**2.3**	**2.7**	**2.7**	**2.7**	**0.9**
Change in structural primary balance		*0.3*	*0.4*	*-0.1*	*0.1*	*0.3*	*0.0*	*0.0*	
Expenditure benchmark									
Public expenditure growth[4] (real)		0.80	0.88	0.97	0.61	0.16	1.37	n.a.	n.a.
Reference rate[5,6]		1.16	1.16	1.16	1.16	*1.16*	*1.16*	n.a.	n.a.
Lower reference rate[5,7]		0.01	0.01	0.01	0.01	*0.01*	*0.01*	n.a.	n.a.
Deviation in % of GDP from applicable reference rate		0.34	0.37	-0.08	-0.23	*-0.42*	*0.09*	n.a.	n.a.
Two-year average deviation in % of GDP from applicable reference rate		n.a.	n.a.	0.13	0.07	*-0.33*	*-0.17*	n.a.	n.a.

Notes:

[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by the Commission on the basis of the information in the programme.

[3]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

[4]Modified expenditure aggregate used for the expenditure benchmark, growth rates net of non-discretionary changes in unemployment benefit and of discretionary measures.

[5]The reference rates applicable to 2014 onwards will be available from mid-2012. For illustrative purposes, the current reference rates have also been applied to the years 2014 onwards.

[6]The (standard) reference rate applies starting in the year following the one in which the country has reaches its MTO.

[7]The lower reference rate applies as long as the country is adjusting towards its MTO, including the year in which it reaches the MTO.

Source :

Commission spring 2012 forecasts (COM); Stability programme (SP); Commission calculations.

Table IV. Debt dynamics

(% of GDP)	Average 2006-10	2011	2012		2013		2014	2015	2016
			COM	SP	COM	SP	SP	SP	SP
Gross debt ratio[1]	**71.5**	**81.2**	**82.2**	**82.0**	**80.7**	**80.0**	**78.0**	**76.0**	**73.0**
Change in the ratio	2.9	-1.8	0.9	0.8	-1.5	-1.8	-2.0	-2.4	-2.6
Contributions[2] *:*									
1. Primary balance	**-0.9**	**-1.6**	**-1.7**	**-1.7**	**-1.6**	**-1.9**	**-2.4**	**-2.6**	**-2.8**
2. 'Snow-ball' effect	**1.3**	**-0.4**	**0.7**	**0.9**	**-0.4**	**0.2**	**0.3**	**0.3**	**0.4**
Of which:									
Interest expenditure	2.7	2.7	2.6	2.6	2.4	2.6	2.6	2.6	2.6
Growth effect	-0.9	-2.4	-0.5	-0.6	-1.3	-1.3	-1.2	-1.2	-1.2
Inflation effect	-0.6	-0.6	-1.3	-1.2	-1.4	-1.1	-1.1	-1.0	-1.0
3. Stock-flow adjustment	**2.6**	**0.2**	**1.9**	**1.6**	**0.6**	**-0.1**	**0.1**	**-0.1**	**-0.2**
Of which:									
Cash/accruals diff.									
Accum. financial assets									
Privatisation									
Val. & residual effects									

(% of GDP)		2011	2012		2013		2014	2015	2016
			COM/ SP[3]	SP[4]	COM/ SP[3]	SP[4]	SP[4]	SP[4]	SP[4]
Gap to the debt benchmark[5,6]	-	-	-	-	-	-	-	-2.0	-3.2
Structural adjustment[7]	-	-	0.4	0.4	0.2	0.2	0.3	-	-
To be compared to:									
Required adjustment[8]	-	-	0.0	0.0	0.0	0.0	0.0	-	-

Notes:

[1]End of period.

[2]The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, the accumulation of financial assets, and valuation and other residual effects.

[3]Assessment of the consolidation path set in the SP assuming growth follows the COM forecasts.

[4]Assessment of the consolidation path set in the SP assuming growth follows the SP projections.

[5]Not relevant during the excessive deficit procedures that were ongoing in November 2011 and in the three years following the correction of the excessive deficit.

[6]Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, the projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[7]Applicable only during the transition period of three years from the correction of the excessive deficit for the excessive deficit procedures that were ongoing in November 2011.

[8]Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that the COM (SP) budgetary projections are achieved.

Source :

Stability programme (SP); Commission spring 2012 forecasts (COM); Commission calculations.

Table V. Long-term sustainability indicators

	DE		EU27	
	No policy change scenario	Stability programme scenario	No policy change scenario	SCPs scenario
S2	1.8	1.1	2.9	0.7
of which:				
Initial budgetary position (IBP)	-0.5	-1.3	0.7	-1.6
Long-term change in the primary balance (LTC)	2.3	2.4	2.3	2.4
of which:				
pensions	1.4	1.5	1.1	1.2
health care and long-term care	1.0	0.9	1.5	1.5
other	-0.1	0.1	-0.3	-0.3
S1 (required adjustment)*	0.6	0.1	2.2	-0.1
Debt, % of GDP (2011)	81.2		82.8	
Age-related expenditure, % of GDP (2011)	24.6		25.8	

Source: Commission, 2012 stability and convergence programmes.

Note: The 'no policy change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves according to the spring 2012 forecast until 2013. The 'stability programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented.

* The required adjustment of the primary balance until 2020 to reach a public debt of 60% of GDP by 2030.

Figure. Medium-term debt projection

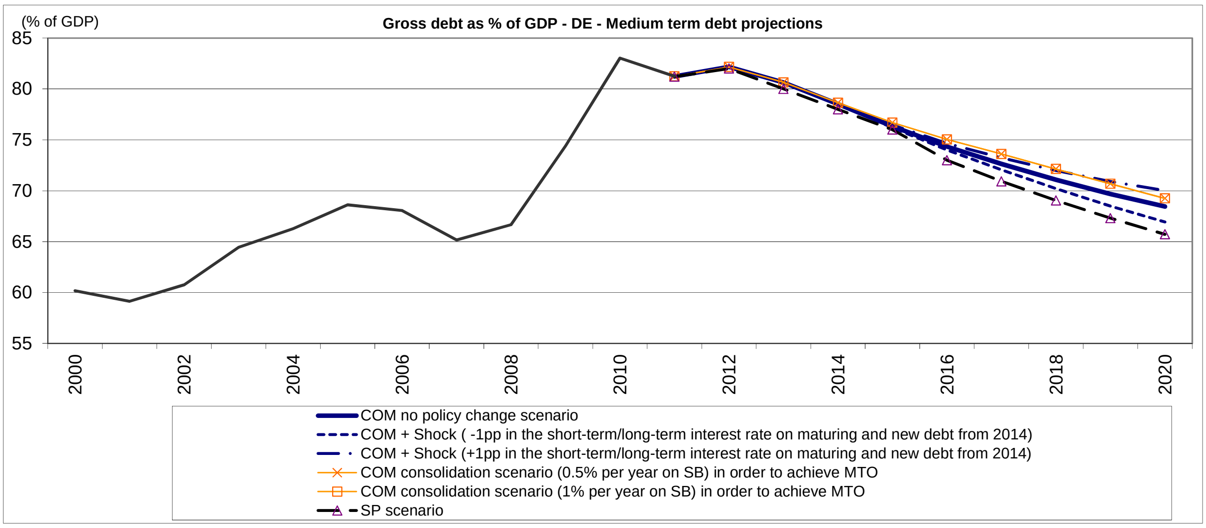

Table VI. Taxation indicators

	2001	2005	2007	2008	2009	2010
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	39.4	38.3	38.7	38.9	39.2	38.1
Breakdown by economic function (% of GDP)[1]						
Consumption	10.5	10.2	10.6	10.7	11.2	10.8
of which:						
- VAT	6.6	6.3	7.0	7.1	7.5	7.3
- excise duties on tobacco and alcohol	0.7	0.8	0.7	0.7	0.7	0.7
- energy	2.1	2.1	1.9	1.8	1.9	1.8
- other (residual)	1.0	1.0	1.0	1.0	1.0	1.0
Labour employed	21.0	19.2	18.3	18.9	19.6	19.1
Labour non-employed	2.7	3.0	2.6	2.6	2.7	2.4
Capital and business income	4.0	4.8	6.0	5.6	4.8	4.9
Stocks of capital/wealth	1.1	1.1	1.1	1.0	1.0	1.0
p.m. Environmental taxes[2]	2.5	2.5	2.2	2.2	2.3	2.2
VAT efficiency[3]						
Actual VAT revenues as % of theoretical revenues at standard rate	58.2	55.1	55.2	55.6	55.5	54.8

Note:

1 Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2012), Taxation trends in the European Union, for a more detailed explanation.

2 This category comprises taxes on energy, transport and pollution and resources included in taxes on consumption and capital.

3 The VAT efficiency is measured via the VAT revenue ratio. The VAT revenue ratio is defined as the ratio between the actual VAT revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). See European Commission (2011), Tax reforms in EU Member States, European Economy 5/2011, for a more detailed explanation.

Source: Commission

Table VII. Financial market indicators

	2007	2008	2009	2010	2011
Total assets of the banking sector (% of GDP)	312.6	319.1	313.2	335.3	326.5
Share of assets of the five largest banks (% of total assets)	22.0	22.7	25.0	32.6	…
Foreign ownership of banking system (% of total assets)	11.1	11.5	10.8	…	…
Financial soundness indicators:					
- non-performing loans (% of total loans)	2.7	2.9	3.3	...	...
- capital adequacy ratio (%) [1)]	12.9	13.6	14.8	16.1	16.6
- return on equity (%) [2)]	6.5	-2.5	5.0	...	...
Bank loans to the private sector (year-on-year % change)	4.1	4.4	0.0	0.0	2.0
Lending for house purchase (year-on-year % change)	-0.5	-0.6	0.2	0.7	1.2
Loan to deposit ratio	92.1	89.6	87.6	84.7	83.3
CB liquidity as % of liabilities	4.1	4.9	3.6	1.7	1.3
Banks' exposure to countries receiving official financial assistance (% of GDP)[4)]	9.8	10.5	8.8	6.8	5.4
Private debt (% of GDP)	104.3	107.3	111.3	106.8	104.1
Gross external debt (% of GDP) [4)]					
- Public	30.9	37.0	38.0	43.4	46.3
- Private	34.7	39.9	38.4	40.4	41.3
Long term interest rates spread versus Bund (basis points)*	0.0	0.0	0.0	0.0	0.0
Credit default swap spreads for sovereign securities (5-year)*	…	21.7	37.5	39.8	65.6

Notes:

[1)] The capital adequacy ratio is defined as total capital devided by risk weigthed assets. Latest September 2011.

[2)] The capital adequacy ratio is defined as total capital divided by risk weighted assets.

[3)] Covered countries are IE, EL, PT, RO, LV and HU.

[4)] Latest data 2011Q3.

* Measured in basis points.

Source:

Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission (long-term interest rates), World Bank (gross external debt) and ECB (all other indicators).

Table VIII. Labour market and social indicators

Labour market indicators	2006	2007	2008	2009	2010	2011
Employment rate (% of population aged 20-64)	71.1	72.9	74.0	74.2	74.9	76.3
Employment growth (% change from previous year)	2.2	2.2	1.5	-0.2	0.7	2.6
Employment rate of women (% of female population aged 20-64)	65.0	66.7	67.8	68.7	69.6	71.1
Employment rate of men (% of male population aged 20-64)	77.2	79.1	80.1	79.6	80.1	81.4
Employment rate of older workers (% of population aged 55-64)	48.1	51.3	53.7	56.1	57.7	59.9
Part-time employment (% of total employment)	26.2	26.5	26.3	26.5	26.6	27.1
Part-time employment of women (% of women employment)	46.4	46.7	46.3	46.1	46.2	46.4
Part-time employment of men (% of men employment)	9.5	9.6	9.5	9.8	9.9	10.5
Fixed term employment (% of employees with a fixed term contract)	14.5	14.6	14.7	14.5	14.7	14.7
Unemployment rate[1] (% of labour force)	10.3	8.7	7.5	7.8	7.1	5.9
Long-term unemployment[2] (% of labour force)	5.8	4.9	4.0	3.5	3.4	2.8
Youth unemployment rate (% of youth labour force aged 15-24)	13.8	11.9	10.6	11.2	9.9	8.6
Youth NEET[3] rate (% of population aged 15-24)	9.6	8.9	8.4	8.8	8.3	:
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	13.7	12.5	11.8	11.1	11.9	:
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	22.0	22.6	23.9	25.7	26.1	:
Labour productivity per person employed (annual % change)	3.1	1.5	-0.1	-5.2	3.2	1.6
Hours worked per person employed (annual % change)	-0.5	-0.1	0.0	-2.7	1.8	0.3
Labour productivity per hour worked (annual % change; constant prices)	3.6	1.7	-0.1	-2.5	1.4	1.3
Compensation per employee (annual % change; constant prices)	0.7	-0.8	1.3	-1.1	1.4	2.2
Nominal unit labour cost growth (annual % change)	-2.0	-0.8	2.3	5.5	-1.1	1.4
Real unit labour cost growth (annual % change)	-2.3	-2.3	1.5	4.2	-1.7	0.6

Notes:

[1] According to ILO definition, age group 15-74)
[2] Share of persons in the labour force who have been unemployed for at least 12 months.
[3] NEET are persons that are neither in employment nor in any education or training.

Sources:
Commission (EU Labour Force Survey and European National Accounts)

Expenditure on social protection benefits (% of GDP)	**2005**	**2006**	**2007**	**2008**	**2009**
Sickness/Health care	8.23	8.06	7.98	8.20	9.66
Invalidity	2.41	2.31	2.21	2.26	2.43
Old age and survivors	9.96	9.67	9.32	9.31	9.97
Family/Children	3.11	2.88	2.81	2.87	3.17
Unemployment	2.10	1.85	1.55	1.44	1.90
Housing and Social exclusion n.e.c.	0.61	0.65	0.61	0.58	0.65
Total	30.0	28.9	27.8	28.0	31.4
of which: Means tested benefits	3.51	3.48	3.28	3.23	3.55
Social inclusion indicators	**2006**	**2007**	**2008**	**2009**	**2010**
Risk-of-poverty or exclusion[1] (% of total population)	20.3	20.7	20.1	20.0	19.7
Risk-of-poverty or exclusion of children (% of people aged 0-17)	21.1	19.8	20.1	20.4	21.7
Risk-of-poverty or exclusion of elderly (% of people aged 65+)	13.6	16.9	15.5	16.0	14.8
At-risk-of-poverty rate[2] (% of total population)	12.5	15.2	15.2	15.5	15.6
Value of relative poverty threshold (single household per year) - in PPS	9100	10395	10804	10772	10634
Severe material deprivation[3] (% of total population)	5.1	4.8	5.5	5.4	4.5
Share of people living in low work intensity households[4] (% of people aged 0-59 not student)	13.5	11.5	11.6	10.8	11.1
In-work at-risk-of poverty rate (% of persons employed)	5.5	7.5	7.1	6.8	7.2

Notes:

[1] People at risk of poverty or social exclusion (AROPE): individuals who are at risk of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in households with zero or very low work intensity (LWI).

[2] At-risk-of poverty rate: share of people with an equivalised disposable income below 60% of the national equivalised median income.

[3] Share of people who experience at least 4 out of 9 deprivations: people cannot afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish, or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour TV, or ix) have a telephone.

[4] People living in households with very low work intensity: share of people aged 0-59 living in households where the adults work less than 20% of their total work-time potential during the previous 12 months.

Sources:

For expenditure on social protection benefits ESSPROS; for social inclusion EU-SILC.

Table IX. Product market performance and policy indicators

Performance indicators	2002-2006	2007	2008	2009	2010	2011
Labour productivity[1] total economy (annual growth in %)	**1.3**	**1.3**	**-0.5**	**-2.5**	**2.4**	**1.4**
Labour productivity[1] in manufacturing (annual growth in %)	**3.0**	**3.0**	**-2.4**	**-8.0**	**9.9**	**n.a.**
Labour productivity[1] in electricity, gas, water (annual growth in %)	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Labour productivity[1] in the construction sector (annual growth in %)	**-0.2**	**-2.0**	**-1.3**	**-1.6**	**1.1**	**n.a.**
Patent intensity in manufacturing[2] (patents of the EPO divided by gross value added of the sector)	**3.2**	**2.9**	**2.5**	**n.a.**	**n.a.**	**n.a.**
Policy indicators	**2002-2006**	**2007**	**2008**	**2009**	**2010**	**2011**
Enforcing contracts[3] (days)	**n.a.**	**535**	**542**	**548**	**549**	**556**
Time to start a business[3] (days)	**n.a.**	**20**	**17**	**15**	**15**	**14**
R&D expenditure (% of GDP)	**1.8**	**1.8**	**1.9**	**2.0**	**2.0**	**n.a.**
Tertiary educational attainment (% of 30-34 years old population)	**26.5**	**30.0**	**31.1**	**32.3**	**33.6**	**n.a.**
Total public expenditure on education (% of GDP)	**5.1**	**5.0**	**5.1**	**n.a.**	**n.a.**	**n.a.**
	2005	**2006**	**2008**	**2009**	**2010**	**2011**
Product market regulation[4], Overall (Index; 0=not regulated; 6=most regulated)	**n.a.**	**n.a.**	**2**	**n.a.**	**n.a.**	**n.a.**
Product market regulation[4], Retail (Index; 0=not regulated; 6=most regulated)	**n.a.**	**n.a.**	**4**	**n.a.**	**n.a.**	**n.a.**
Product market regulation[4], Network Industries[5] (Index; 0=not regulated; 6=most regulated)	**3**	**3**	**3***	**n.a.**	**n.a.**	**n.a.**

Notes:

[1]Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.

[2] Patent data refer to applications to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.

[3] The methodologies, including the assumptions, for this indicator are presented in detail on the website http://www.doingbusiness.org/methodology.

[4] The methodologies for the product market regulation indicators are presented in detail on the website http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html. The latest available product market regulation indicators refer to 2003 and 2008, except for Network Industries.

[5] Aggregate ETCR.

*figure for 2007.

Source :

Commission, World Bank - *Doing Business* (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).

Table X. Green growth indicators

Germany		2001-2005	2006	2007	2008	2009	2010
Green Growth performance							
Macroeconomic							
Energy intensity	kgoe / €	0.17	0.16	0.15	0.15	0.15	0.15
Carbon intensity	kg / €	0.49	0.46	0.43	0.43	0.42	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	0.63	0.60	0.58	0.57	0.57	n.a.
Waste intensity	kg / €	n.a.	0.17	0.16	0.16	n.a.	n.a.
Energy balance of trade	% GDP	-2.0%	-2.8%	-2.4%	-3.5%	-2.5%	-2.9%
Energy weight in HICP	%	10	11	11	12	12	12
Difference between change energy price and inflation	%	3.84	8.7	1.4	8.6	-2.6	-0.8
Environmental taxes over labour taxes	ratio	10.7%	10.8%	10.4%	10.0%	9.9%	n.a.
Environmental taxes over total taxes	ratio	6.5%	6.1%	5.7%	5.6%	5.7%	n.a.
Sectoral							
Industry energy intensity	kgoe / €	0.12	0.11	0.11	0.11	0.11	n.a.
Share of energy-intensive industries in the economy	% GDP	10.1	10.7	10.8	10.9	3.1	n.a.
Electricity prices for medium-sized industrial users	€ / kWh	0.07	0.09	0.09	0.09	0.10	0.09
Public R&D for energy	% GDP	n.a.	0.02%	0.02%	0.03%	0.03%	n.a.
Public R&D for the environment	% GDP	n.a.	0.01%	0.02%	0.02%	0.03%	n.a.
Recycling rate of municipal waste	ratio	56.4%	70.4%	74.7%	76.7%	77.5%	n.a.
Share of GHG emissions covered by ETS	%	n.a.	47.7%	49.7%	48.2%	46.6%	n.a.
Transport energy intensity	kgoe / €	0.56	0.52	0.50	0.48	0.52	n.a.
Transport carbon intensity	kg / €	1.53	1.28	1.25	1.20	1.28	n.a.
Change in the ratio of passenger transport and GDP	%	-0.1%	-1.6%	-1.9%	-2.9%	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	60.9%	61.3%	58.7%	60.9%	61.6%	n.a.
Diversification of oil import sources	HHI	n.a.	0.00	0.00	0.00	0.00	n.a.
Diversification of energy mix	HHI	0.26	0.25	0.24	0.25	0.24	n.a.
Share of renewable energy in energy mix	%	3.8%	5.7%	7.6%	7.8%	8.5%	n.a.

<u>Country-specific notes</u>:
The year 2011 is not included in the table due to lack of data.
<u>General explanation of the table items:</u>
Source: Eurostat unless indicated otherwise; ECFIN explanations given below
All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)
- Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)
- Carbon intensity: Greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)
- Resource intensity: Domestic Material Consumption (in kg) divided by GDP (in EUR)
- Waste intensity: waste (in kg) divided by GDP (in EUR)

Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP
Energy weight in HICP: the share of the "energy" items in the consumption basket used in the construction of the HICP
Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual %-change)
Environmental taxes over labour or total taxes: from DG TAXUD's database "Taxation trends in the European Union"
Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in EUR)
Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP
Recycling rate of municipal waste: ratio of municipal waste recycled over total municipal waste
Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP
Share of GHG emissions covered by ETS: based on greenhouse gas emissions as reported by Member States to EEA (excl LULUCF)
Transport energy intensity: final energy consumption of transport (in kgoe) divided by gross value added of industry (in EUR)
Transport carbon intensity: greenhouse gas emissions in transport divided by gross value added of the transport sector
Passenger transport growth : measured in %-change in passenger kilometres
Energy import dependency: net energy imports divided by gross inland energy consumption incl. of international bunkers
Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin
Diversification of the energy mix: Herfindahl Index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels
Share of renewable energy in energy mix: percentage-share in gross inland energy consumption, expressed in tonne oil equivalents