Federal Ministry of Economics and Technology

BUSINESS.
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2012 Annual Economic Report
Boosting confidence – generating opportunities – continuing to grow with Europe

Imprint

Publisher
Federal Ministry of Economics and Technology (BMWi)
Public Relations
D-10115 Berlin, Germany
www.bmwi.de

Text and editing
Federal Ministry of Economics and Technology
Editing team JWB 2012
JWB2012@bmwi.bund.de

Status
January 2012

Print
Silber Druck oHG, Niestetal

Design and production
PRpetuum GmbH, München

Cover photograph
SuperStock – mauritius images

Zertifikat seit 2002
audit beruf**und**familie

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Preface

Making long-term and broad-based growth possible on the basis of the Social Market Economy – that is the clear principle for the Federal Government's economic policy. A growing economy creates space for new jobs and social security. Growth is also the foundation for a prosperous society and the resolution of our society's pressing problems. The Federal Government's 2012 Annual Economic Report certainly reflects this goal. It contains a clear commitment to values-based economic growth in order to secure prosperity and future opportunities both for our people today and for generations to come.

Following two years of extraordinary annual growth rates of around three percent, Germany's economy is in an encouragingly robust state. It is true that the level of dynamism is declining in view of the increased risks in the European and international environment. But our citizens are continuing to benefit from the growth in our corporate sector. More people are now in work than at any other time since the founding of the Federal Republic. Wages and purchasing power are rising appreciably. The central task for Germany's economic policy is therefore to strengthen people's confidence in Germany, to open up opportunities for them, and to stabilise growth in this way.

A fundamental precondition for continuous growth is that we must continue to orient ourselves to the Social Market Economy. This is equally true both for Germany and for Europe. The process of integration and the common currency are some of Europe's greatest achievements. They safeguard peace and prosperity. The time has now come for Europe to develop further into a genuine union of stability. Germany is actively helping to pave the way there. This includes strengthening subsidiarity and individual responsibility. Each country is called on to improve its competitiveness and to put its public finances on a viable footing. Germany continues to be an anchor of stability and growth in Europe. But it is vital for all the countries to have the strength in their own economies for them to be able to keep up in the long term.

If we are to succeed here, it is vital that individuals, companies and financial markets have confidence in the performance of the European economy. The Federal Government is putting the policies in place to equip Germany for the future. It is making the tax system fairer, and it is cutting the welfare contributions. At the same time, it is continuing the pro-growth consolidation of the public-sector budgets. The effects of the skills shortage are already being felt, and the Government is addressing this problem with education and training, family policy and immigration. The reorientation of our energy policy offers an opportunity for a broad wave of modernisation. At the same time, we will ensure that energy remains secure and affordable.

To a large extent, growth in Germany is driven by innovation. It relies on people who enjoy competing, who are open to new technologies, and who are capable of innovating. These qualities are of crucial importance for the solving of our economic, social and environmental challenges, and are an integral element of our Social Market Economy. At the same time, growth is not an end in itself, but opens up scope for individuals so that they can take their own decisions and action. The Federal Government will do its utmost to preserve and extend this scope for individual responsibility.

Sincerely yours,

Dr. Philipp Rösler
Federal Minister of Economics and Technology

Executive Summary

1. Continuous growth in Germany is unthinkable without growth in Europe – and vice versa. After all, Germany is the anchor of stability and driving force for growth in Europe. This is true of its willingness to reform, its public finances and its stable monetary and fiscal system. The Federal Government will further strengthen the forces for growth and improve the preconditions for a continuous process of upward economic development in Germany. These efforts will be based on the successful principles of the Social Market Economy.

2. The forces driving Germany's growth are intact. The population is benefiting from the upswing in several respects: from more jobs, higher incomes and better opportunities. The domestic economy is increasingly becoming a pillar supporting Germany's growth. This is strengthening the resilience of Germany's economy with regard to external risks and is also benefiting Germany's trading partners.

3. In the course of last year, economic activity in Germany regained the pre-crisis level of spring 2008. The post-crisis recovery process was thus even more dynamic than the Federal Government had anticipated a year ago. The upswing was – not least in the international comparison – very powerful indeed: gross domestic product expanded by 3.0 percent (price-adjusted) in 2011, following an increase of 3.7 percent the year before. However, in the course of last year the level of debt in a number of industrial countries – often coupled with doubts about their competitiveness – engendered tangible uncertainty on the capital markets. As a result, the expectations in the performance of the German economy clearly fell in the second half of 2011. Growth slowed down.

4. In its annual projection for 2012, the Federal Government expects a temporary phase of cyclical weakness, but not a recession. As the year progresses, the Germany economy will return to a faster pace of growth. The Federal Government anticipates that price-adjusted gross domestic product will grow by 0.7 percent in annualised terms. This implies that the German economy will continue to grow rather more strongly than the eurozone as a whole.

5. Growth in Germany was already being mainly driven by the domestic economy in the last two years. And the forces driving growth will shift further across to the domestic economy. As a result of the significant slow-down in growth in the international and, in particular, in the European context, exports are only likely to record a moderate expansion this year. In view of the dynamic development in imports, the calculated contribution to growth by net foreign demand, which derives from the difference between exports and imports, will be negative. In contrast, consumer spending will have an appreciable impact on growth. And the environment for investment remains favourable.

Overview 1: Selected key figures for macroeconomic trends in the Federal Republic of Germany[1]

	2010	2011	Annual projection 2012
	Year-on-year changes in percent unless stated otherwise		
Gross domestic product (price-adjusted)	**3.7**	**3.0**	**0.7**
Employment (domestic)	0.5	1.3	0.5
Unemployment rate in percent (as defined by the Federal Employment Agency)[2]	*7.7*	*7.1*	*6.8*
Use of GDP **(price-adjusted, in real terms)**			
Private households and private non-profit institutions	0.6	1.5	1.2
Machinery and equipment	10.5	8.3	2.0
Construction	2.2	5.4	0.8
Domestic demand	2.4	2.2	1.1
Exports	13.7	8.2	2.0
Imports	11.7	7.2	3.0
Net foreign demand (contribution to GDP growth rate)[3]	*1.5*	*0.8*	*-0.3*
Gross wages and salaries per employee (nominal)	2.2	3.4	2.4

1 Up to 2011, preliminary figures from the Federal Statistical Office as of 11 January 2012;
2 Based on total number of persons employed;
3 Contribution to GDP growth rate.

6. The Federal Government expects the positive development on the labour market to continue in 2012. Overall, the Federal Government anticipates a further increase in gainful activity by roughly 220,000 people in annualised terms. This year is expected to post a new record for employment figures. It will in turn be possible to fill some of the newly created jobs with workers from the hidden reserves. In the light of the expected decline in the working population, the ongoing mobilisation of the labour market's hidden reserves is especially welcome.

7. The Federal Government's annual projection is based on the central assumption that the solution to the debt crisis in Europe continues to make headway and that the uncertainty on the markets will gradually dissipate. The main risk to economic development in 2012 is undoubtedly a worsening of the crisis. On the other hand, a rapid resolution of the debt crisis also unquestionably represents an opportunity for a more positive development. If the uncertainty amongst the market participants disappears more quickly than has been assumed, economic activity could return to even faster growth.

8. Europe's successful integration stands for peace and prosperity. As a common currency, the euro is the logical and necessary continuation of the process of European integration. It has demonstrated its great advantages. The debt crises in certain European countries show that these advantages can only be secured on a permanent basis if there is more European integration and better stability. Europe needs to become a union of stability with common values, credible rules and clear sanctions.

9. The Federal Government will play a proactive role in shaping the necessary steps towards more stability and sustainable growth on a basis of economic reason. A new economic and fiscal constitution for the eurozone must be based on the principles of subsidiarity, individual responsibility and liability: principles which have proved their worth in the Social Market Economy.

10. Here, the focus is on prevention. The lack of competitiveness in certain member states was a major trigger for the loss of confidence in a stable economic and financial development in these countries. The new procedure to avoid and correct macroeconomic imbalances is to help prevent future crises by revealing bad economic developments or competitive weaknesses which can jeopardise stability in the eurozone at an early stage and by correcting them – if necessary with the backing of sanctions. The procedure is primarily concentrated on countries with weaknesses in competitiveness which find particular expression in high current-account deficits. In the form of the Euro Plus Pact, the heads of state and government of the euro countries and other EU members adopted a further element to improve growth and competitiveness in Europe in March 2011.

11. In order to safeguard the long-term viability of the public-sector budgets in all member states, the community has significantly increased the requirements to be met by national fiscal policies. The rules of the European Stability and Growth Pact have been substantially tightened. The heads of state and government have also decided to establish a fiscal stability union by intergovernmental treaty. Following the model of Germany's "debt brake", which is anchored in its Constitution, the euro countries have committed themselves to introducing a national rule for a balanced budget at constitutional or equivalent level. The preventive monitoring of national budget policies and the corrective arm of the Stability and Growth Pact have been strengthened. In future, the EU will have stronger powers to launch automatic steps against countries undergoing a deficit procedure and to impose sanctions. Corresponding measures are to be put in place by the end of March 2012 at the latest.

12. In order to be able to tackle the current debt crises and to prevent future debt crises from impacting on the stability of the entire eurozone, the member states of the eurozone set up stabilisation mechanisms back in mid-2010. The temporary European Financial Stability Facility (EFSF) is being replaced by the permanent European Stability Mechanism (ESM). The ESM will start to function in the course of 2012. One major difference between the two bail-out systems is that ESM members commit themselves to introduce standardised debt restructuring clauses ("Collective Action Clauses", or CACs). However, the emergency assistance cannot substitute for structural reforms and adjustments in the real economy. The Federal Government rejects Eurobonds.

13. Banks will have to meet tougher capital adequacy and liquidity rules *(Basel III)* in future. This will make them more resilient both in the face of macroeconomic crises and when exposed to normal market risks. The Federal Government will be closely involved in the EU negotiations on the implementation of *Basel III* and will ensure that corporate financing is not impaired by the new rules. Where banks are especially large or play a key role in the financial system for other reasons, the rules need to be particularly strict. They are to cover themselves with additional funds of their own in future. Should a bank prove unable to meet its need for capital on the market in the context of the co-ordinated approach at EU level, the Financial Market Stabilisation Fund, which expired at the end of 2010, will be reopened up to the end of 2012.

14. In view of the debt problems in the eurozone, the central task for fiscal policy is to safeguard confidence in public finances which are viable in the long term. For this reason, Germany will comply fully with all the consolidation obligations it has taken on at national and international level.

15. Last year, the public-sector deficit rate was 1.0 percent – once again well below the 3 percent Maastricht criterion. Despite additional burdens on the budget, the Federal Government will continue resolutely with the consolidation. In 2012 budget and the financial plan up to 2015, the Federal Government falls well below the maximum net borrowing which is admissible each year according to the “debt brake” rules.

16. In the system of the progressive income tax tariff, the state profits from tax revenues generated by the effect of fiscal drag. For this reason, the Federal Government adopted a draft law on 7 December 2011 which reduces additional tax burdens deriving from fiscal drag in two steps, as of 1 January 2013 and 1 January 2014. A regular review of the effect of fiscal drag across the tax rates is to take place every two years from the 18th period of legislation.

17. The Federal Government wishes to take advantage of the opportunities of demographic change and tackle the related challenges in a positive manner. It took an important step in June 2011 with its concept to secure the availability of skilled workers: it lists the measures to improve the opportunities to participate on the labour market especially for women, older workers, the low-skilled, and people with a migrant background. Furthermore, the Federal Government will present a demography strategy in spring 2012. In addition to this, Germany needs to become more attractive for skilled workers from abroad. The salary threshold above which highly skilled foreign workers are permitted to establish themselves in Germany without bureaucracy and without delay is down from 66,000 to 48,000 euro. The Federal Government is taking advantage of the scope offered by the EU’s directive on highly skilled workers, and is designing the EU Blue Card in an attractive way.

18. Germany’s upswing in employment is reflecting the responsible attitude of the parties in the collective bargaining process and the good situation of the economy. It is also the product of greater flexibility on the labour market. The Federal Government will continue resolutely along its path to foster higher employment and growth. The effects on the labour market of the current allowances for people in work are being observed so that if appropriate the necessary changes can be made this year. The Federal Government is also examining the increase in and dynamisation of the threshold for minijobs not subject to social security contributions.

19. Above all, the companies themselves need to promote the work ability and the employability of their employees throughout their working lives. In particular this includes expanding the following: appropriate work for older workers, forward-looking design and organisation of work, tailored further training, and promotion of health in the workforce.

20. The Federal Government will also continue to develop the long-term care insurance system. In general, the reform of this system aims at more needs-based services, particularly for those suffering from dementia. The work on a new concept of persons in need of long-term care will completed during this period of legislation.

21. In the 8th revision of the Act Against Restraints of Competition, the Federal Government aims to modernise the general framework for competition in Germany. In addition, it will in particular further increase the level of competition in the transport sector. To this end, it is revising the regulations governing the railway sector.

Furthermore, long-distance coach transport is to be largely liberalised. By revising the Telecommunications Act, the Federal Government is strengthening competition in the telecommunications sector. Excessive bureaucracy stifles competition. By adopting key points to further reduce the burden of costs of bureaucracy on business last year, the Federal Government has initiated further measures to reduce bureaucracy which will ensure that the goal of cutting at least one quarter of the bureaucratic burden will be achieved.

22. A modern and efficient transport infrastructure is a vital precondition for ongoing growth. The Federal Government has stabilised the annual investments in rail, road and waterways at a level of around 10 billion euro in the medium-term financial planning. Further to this, the Federal Government has increased federal investment in transport infrastructure by 500 million euro this year and by a total of another 500 million euro in the years up to 2016.

23. The joint Federal-*Länder* programme *"Improving the Regional Economic Structure"* and European structural policy are key tools of regional policy. The Joint Programme makes a high level of regional support possible in 2012, with a total of 597 million euro of federal funding. The Federal Government is tackling the remaining structural challenges in the eastern German *Länder* with its successful support strategy to boost the forces for growth and the competitiveness of this part of Germany. In the forthcoming programming period from 2014 to 2020, the EU structural funds are to make a contribution as a central instrument to attain the goals of the Europe 2020 growth and jobs strategy.

24. With its numerous activities in the fields of promoting research and innovation, training, support for new start-ups, and standardisation, the Federal Government is creating an outstanding climate for innovation, not least in the international comparison. The aim is for research and innovation to help tackle the major, global challenges facing society in the future – such as climate change, the ageing society or security. In the form of the High-Tech Strategy 2020, the Federal Government has developed an overarching strategy to address the central fields of particular urgency and social relevance: climate/energy, health/nutrition, communications, mobility and security.

25. Above all, innovative companies need to function in an environment which foster innovation. The Federal Government is taking numerous measures to stimulate a permanently higher level of dynamism in the field of new start-ups, since innovative new businesses create jobs with a future and transform ideas and academic findings into marketable products. The Federal Government will revise the system of statutory metrology in order to adapt it to international and technical developments, for example in nanotechnology, and to further expand the excellent high-quality infrastructure. In the field of telecommunications, the Federal Government is aims to foster the establishment and expansion of modern broadband networks in a needs-based manner. Further to this, Federal Government has established a framework so that at least one million electric vehicles can drive on Germany's roads by 2020. One of the key aspects here is the promotion of research and development.

26. The Federal Government took an important step towards the restructuring of Germany's energy supply in the form of last year's energy package. The re-orientation of Germany's energy policy is now being realised. The aim is for renewable energy sources to provide the main share of our energy supply in future. By 2050, at least 60 percent of total energy demand and 80 percent of electricity generation in Germany is to be covered by renewables. Following the Fukushima disaster, Germany also reconsidered the role nuclear power has to play. In a step-by-step process up to the end of 2022, the generation of energy in German nuclear power stations will cease entirely.

27. An energy supply based on renewables requires efficient infrastructure which meets the technical needs of the fluctuating quantities generated from renewable forms of energy. When it comes to expanding renewable forms of energy, therefore, the aspects of grid expansion, storage and power plants are therefore of central significance. According to the Renewable Energy Sources Act, producers of electricity from renewable energy sources may feed the electricity they generate into the grid (priority feed-in) and receive guaranteed minimum fees which are generally higher than the market price.

28. Energy efficiency is plays a vital role in a successful re-orientation of energy policy. It reduces the level of dependency on imports and cuts the costs of energy

for companies and consumers. Here, the priority for the Federal Government is a market-based solution which provides incentives for households and companies to boost their energy efficiency.

29. The Federal Government is also working at international level to attain a stable and reliable regulatory framework for economic activity. In addition to world trade and the financial markets, this also particularly applies to the international commodities markets and a transparent exchange rate policy with market-based exchange rates. In the context of the Framework for Strong, Sustainable and Balanced Growth, the Federal Government is working in the G20 to reduce excessive global imbalances and in particular to tackle structural causes of current account surpluses and deficits.

30. Free access to the world's fast-growing markets is vital for ongoing economic growth in Germany and worldwide. For this reason, the Federal Government is sticking to the objective of successfully concluding the Doha Round. Against the background of the lack of agreement in the Doha Round, the conclusion of bilateral EU free-trade agreements with leading high-growth regions is of especial significance. From the German point of view, the priority is on the regions of southeast Asia and Latin America.

31. The Federal Government also takes on responsibilities in terms of development policy in the G20 context. For example, it is pressing ahead in the context of the G20 process with the issues of financing for small and medium-sized enterprises in developing countries, private-sector sector and employment..

32. The assumption of social responsibility by companies and individuals strengthens the Social Market Economy at national and international level. The OECD's guidelines on multinational enterprises have been revised In order to promote responsible corporate governance at international level. In this way, the Federal Government is fostering corporate social responsibility when investments are made abroad and is preventing concomitant negative repercussions for society, commerce and the environment. The Federal Government is promoting corporate involvement outside the core business field with its National Strategy for Active Citizenship.

I. Boosting confidence – generating opportunities – continuing to grow with Europe

A. Germany – anchor of stability and driving force for growth in Europe

33. Prosperity in Germany and Europe are two sides of the same coin. Continuous growth in Germany is unthinkable without growth in Europe – and vice versa. After all, Germany is an anchor of stability and a driving force for growth in Europe.

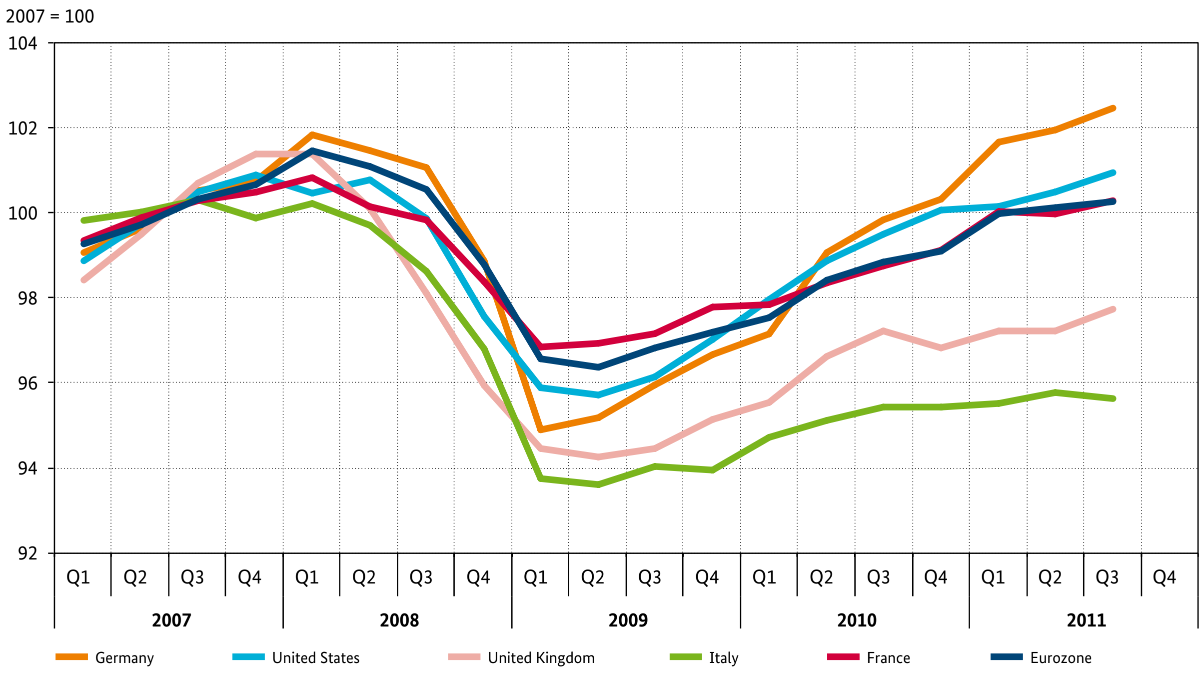
First, this is true of its readiness to reform. With resolute structural improvements on its labour and product markets, Germany has created the foundations for innovations, high competitiveness, robust growth and record employment. As a result, German companies have been able to overcome the effects of the financial market and economic crisis of 2008/09 considerably more quickly than those of other European countries (cf. Figure 1). The process of economic recovery is continuing.

Second, this is true of public finances. Germany is consolidating its public finances in a sustainable and pro-growth manner – with the help of the debt brake, the Federal Government's consolidation package and the efforts by the *Länder* to save money. Thanks to strict discipline on expenditure, the deficit rate dropped back well below the 3 percent Maastricht criterion last year. Viable public finances and greater tax fairness boost confidence amongst companies and individuals. This creates the basis for more investment and consumption, and thus also for sound endogenous growth.

Third, this applies to a stable monetary and fiscal system: At European and international level, Germany stands for a stable euro and a robust banking and financial system. This means that liability and responsibility need to be anchored back where they belong: with the players in the financial system, and not the community of nations and the taxpayers.

34. The Federal Government will further strengthen the forces for growth and improve the preconditions for a continuous process of upward economic development in Germany. These efforts will be based on the successful principles of the Social Market Economy. Here, confidence and optimism are crucial. Individuals and companies need to be able to grasp their opportunities in open markets and competition, and to gener-

Figure 1: GDP trends in the international comparison (adjusted for price, seasonal and calendar variations)



Source: OECD; own calculations

ate greater prosperity. For them to be able to do so, there must be equal opportunities and equal participation, a fair system of taxes and charges, well-trained skilled workers, a high level of innovation and a secure, affordable and environmentally compatible supply of energy.

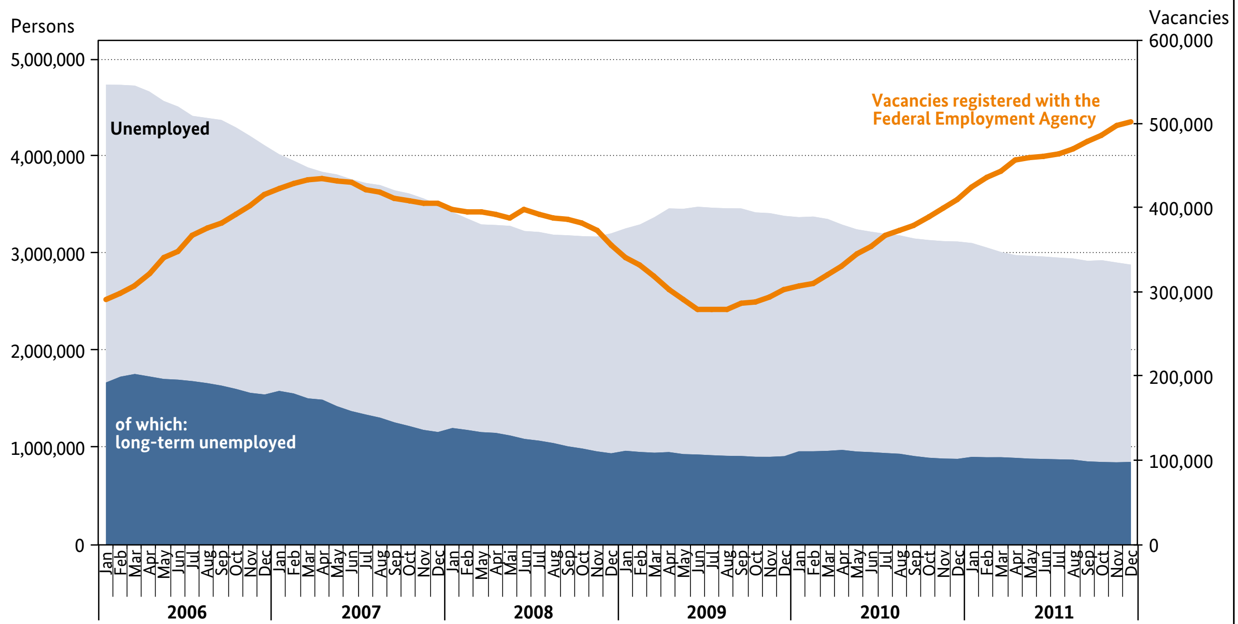
35. The forces driving Germany's growth are intact. The population is benefiting from the upswing in several respects: from more jobs, higher incomes and better opportunities.

Unemployment is now at its lowest level for 20 years. Germany's unemployment rate is one of the lowest in Europe. The drop in the number of long-term unemployed, i.e. people who have been out of work for a year or more, has been greater in percentage terms since 2006 than the overall number of unemployed (cf. Figure 2). In comparison with 2005, it has actually fallen by more than 40 percent. At the same time, the number of gainfully active people in the Federal Republic of Germany is higher than ever before at 41 million. The vast majority of people in employment are in jobs subject to the payment of social security contributions, and the number of people in full-time employment is rising faster than those in part-time jobs. Some regions basically have full employment. The people are benefiting from the upswing in employment. Wages are rising appreciably. Disposable income of private households is likely to rise by 3.0 percent this year, after +3.3 percent last year. This will be the largest increase in disposable income in two consecutive years since the post-reunification boom. This boosts purchasing power, creates confidence and strengthens the domestic economic development in Germany.

36. The domestic economy is increasingly becoming a pillar supporting Germany's growth (cf. Figure 3). This will strengthen the German economy's resilience to external risks. The trading partners of German firms in Europe and around the world are also benefiting from the powerful domestic economy (cf. Figure 4).

Good conditions in Germany for continuous growth are all the more important since the cyclical risks deriving from the European and international environment have clearly increased since summer 2011. The global economy has cooled. In view of the debt crises in certain eurozone countries, the prospects for growth in Europe have deteriorated. If Europe is to

Figure 2: Unemployment and vacancies in Germany



Unemployed, reported vacancies, seasonally adjusted figures; long-term unemployed: unadjusted fitures, excluding data from accredited municipalities

Source: Federal Employment Agency

have a viable future, the member states need to improve their competitiveness and restore confidence in the soundness of their fiscal policies. That is the basic precondition for the common European currency to enjoy sustainable stability.

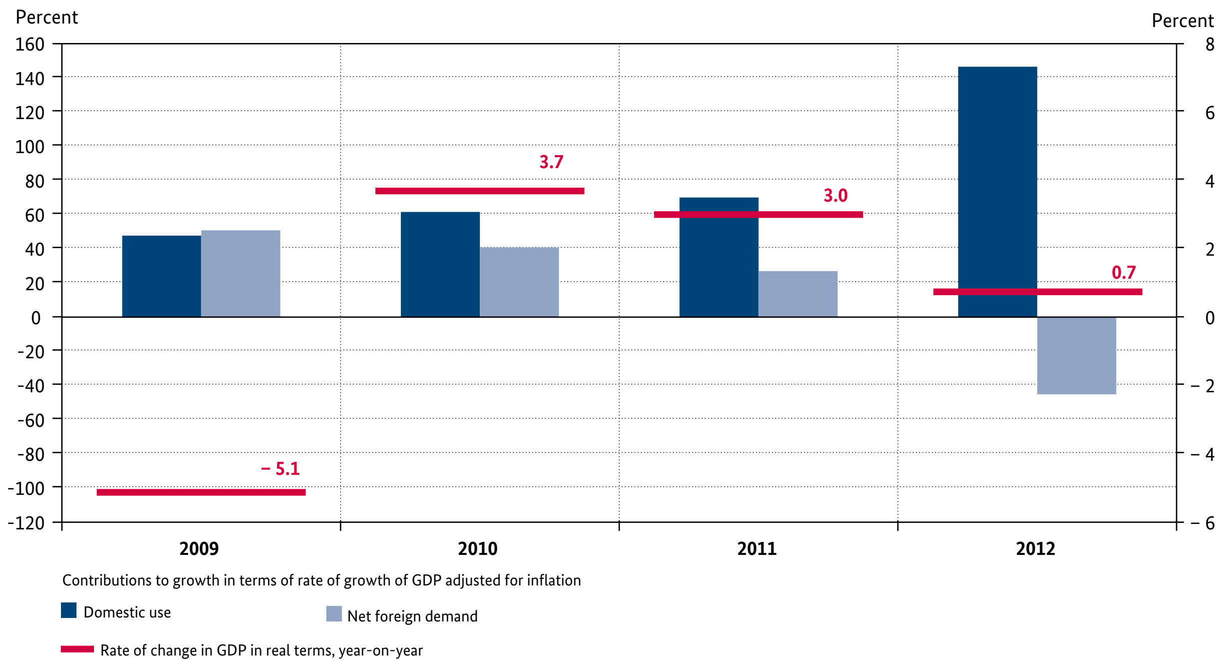
37. Strengthening confidence, opening up opportunities and growing continuously with Europe: that is the overall guideline for Germany's economic policy. Working from these principles, the Federal Government is establishing a platform on which to manage short-term risks and at the same time to strengthen the opportunities for continuous and sustainable growth in Germany and Europe.

Strengthening the foundations for a sound economic policy in Europe

38. The Federal Government is actively helping to determine the route to greater stability in Europe. Europe's successful integration stands for peace and prosperity. It is the response to two disastrous world wars in the first half of the 20th century. It stands for the overcoming of the gulf between East and West which divided the people in Germany and Europe during the Cold War. And it is the response to a changing global power structure in the 21st century: more than ever, the community of European nations is called on to play a pro-active part at international level so that the world's economic, social and environmental challenges can be mastered.

39. The common European currency is the logical and necessary continuation of the process of European integration. The euro has demonstrated its great advantages for consumers and companies in Germany and Europe: average inflation was higher in the days of the deutschmark than it has been since the introduction of the single currency. The common currency makes it easier to pay and to travel in the eurozone. Exchange-rate fluctuations in the eurozone are a thing of the past. The euro also provides protection against sharp exchange-rate fluctuations compared with the currencies of leading trading partners; Germany's export-oriented economy particularly benefits from this. The euro makes prices comparable, boosts inner-European trade, and results in more competition. It is the world's second most im-portant investment and reserve currency after the US dollar.

Figure 3: The domestic economy – a basis for growth in Germany



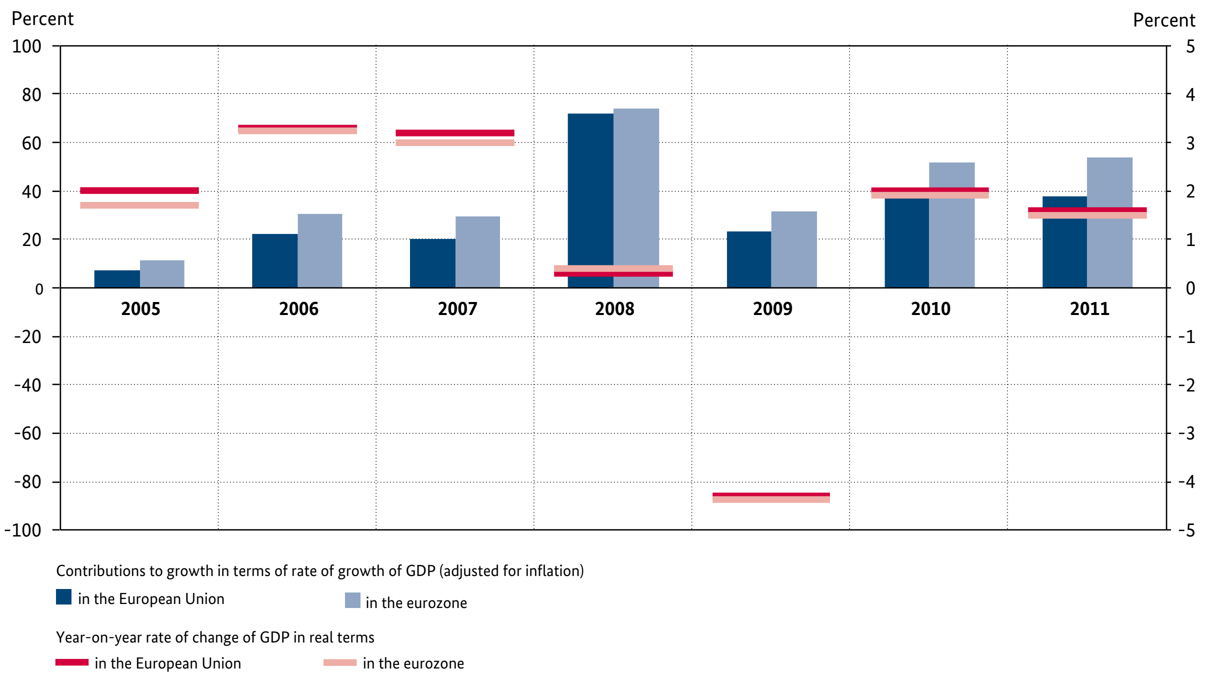
Source: Federal Statistical Office; own calculations

40. The advantages of a common currency can only be secured in the long term by more European integration. Europe needs to become a union of stability with common values, credible rules and clear sanctions. A European culture of stability needs to be built on the common conviction that the market-based principles of liability and responsibility for one's actions form the foundation for the shaping of fiscal and economic policies in the European Union. It must strengthen subsidiarity and the responsibility of the euro member states, and it must resolutely and effectively punish violations of common rules by individual members. Europe is founded on democratic legitimation and the national responsibility of member states for their own budget and economic policies. The member states are fundamentally obliged to bear this responsibility themselves: not the community of nations, and not the European taxpayer. That would create false incentives. For this reason, the subsidiarity principle is a central yardstick for future European economic policy. The Federal Government will continue to call for this approach to be cast in a European economic and fiscal constitution based on the economic principles of the Social Market Economy. After all, the European monetary union will function better and will be closer to the individual citizens if the member states have to assume responsibility for their own actions.

41. Resolute sanction mechanisms must create the right incentives for all the eurozone countries to strengthen their competitiveness and pursue sound budget policies in good time. It must be clear that those who fail to do this will have to expect consequences. One of the core elements of a market economy is a functioning price mechanism. Government debts which are not sustainable incur high risk premiums and thus high interest rates. This is an effective incentive for countries to reduce their burden of debt. This market-based interest-rate mechanism must be able to exert its disciplining influence in the eurozone.

42. Monetary policy is no substitute for a stability-oriented fiscal policy – as is also stressed by the German Council of Economic Experts (GCEE) (cf. GCEE Annual Report, Item 181). The independence of the European Central Bank is of great value. It has a clear mandate to maintain monetary stability. For the prospects of growth in Germany and Europe, it is crucial that individuals and companies have confidence in this obligation.

Figure 4: Germany – driving force for growth in Europe



Source: Eurostat; own calculations

43. The focus of the future rules on budget monitoring and economic policy co-ordination in Europe will be on more effective prevention. The aim is to stop debt crises from arising in the first place in future. For this reason, the member states commit themselves not only to sound budgets but also to promote competitiveness, stability and growth.

44. The procedure to prevent and correct excessive macroeconomic imbalances, which entered into force in December 2011, is an important element on the road to stable economic developments in the member states of the EU. The aim is to detect weaknesses in competitiveness and the financial stability of individual member states at an early stage and to give recommendations on correcting these problems. If a country does not follow the recommendations, this can ultimately result in sanctions being imposed on eurozone countries (cf. Items 63 f.).

At the initiative of Germany and France, numerous member states have also taken on additional voluntary commitments in order to foster growth and competitiveness in Europe in the context of the new Euro Plus Pact. Its implementation is being monitored in the context of the new European Semester – the cycle of economic and fiscal policy monitoring (cf. Items 61 f.). In the context of the first European Semester in 2011, the European Commission also assessed the efforts made so far by the member states of the European Union to reform, and the Council issued country-specific recommendations for further structural reforms. Germany has already made great progress on implementing the two catalogues of measures (cf. Box 1 and Box 2).

45. The European Stability and Growth Pact was also tightened up. In future, sanctions will be imposed more quickly and be more rules-based. The automatic nature of this must be strengthened further – in the interest of greater credibility and impact.

Furthermore, several member states have already followed the German example and are anchoring national debt brakes in their constitutions aimed at structurally balanced budgets. This is making fiscal policy prevention into part of a new European culture of stability which is founded on binding rules.

Box 1: German programme of action for the Euro Plus Pact

The Federal Government will ...
in order to promote competitiveness

1. safeguard Germany's leading position in key technologies via the "Key technologies and horizontal measures" framework programme (cf. Item 148)
2. involve skilled workers from abroad in economic life and promote the integration of migrants in the labour market (cf. Items 119 f.)
3. promote internationally visible cutting-edge research via the Excellence Initiative (cf. Item 149)
4. support higher education institutions via the Higher Education Pact (cf. Items 126 and 149)
5. promote education at an early age via the Early Opportunities Campaign: kindergartens language and integration priority (cf. Item 123)
6. increase the funding for transport infrastructure (cf. Items 102 and 139 f.)
7. revise the Telecommunications Act to achieve high-performance broadband infrastructure (cf. Items 136 and 156)
8. promote innovation for electric motors via the government's Electric Mobility Programme (cf. Items 158 and 181)
9. launch a market transparency office in order to detect and punish manipulation of electricity and gas prices (cf. Item 179)
10. strengthen competition and grid expansion in the field of electricity and gas by implementing the third internal market directive on electricity and gas in national law (cf. Items 166 and 177)
11. promote the development towards renewable energy by revising the Energy Research Programme (cf. Item 176, Box 9)

12. liberalise long-distance coach transport (cf. Item 135)
13. revise the Act Against Restraints of Competition in order to strengthen competition (cf. Item 134)

in order to promote employment ...

14. improve educational opportunities via the competition "Advancement through Education: Open Universities" (cf. Item 124)
15. tackle deficiencies in reading and writing skills of adults via the Basic Education Pact (cf. Item 125)
16. reform the instruments of labour market policy and thus ensure that they are used more effectively and efficiently (cf. Item 115)
17. introduce a period of leave for long-term care for family members in order to make it easier to combine work and care provision (cf. Item 130)
18. use the possibilities of the Federal Voluntary Service to support career choices or reintegration into a career, especially in the welfare field (cf. Item 126)

in order to improve the long-term sustainability of public finance ...

19. drop below the three percent reference item of the Maastricht criteria as early as 2011 rather than in 2013 (cf. Item 98)
20. fall below the reduction curve of the debt brake in 2011 and 2012 (cf. Item 99)

in order to strengthen financial stability ...

21. strengthen investor protection and the functioning of the capital market via more efficient regulation and supervision of the capital market (cf. Items 84, 86 ff., 95)
22. involve banks in the costs of dealing with a bank in trouble via a Restructuring Fund Ordinance (cf. Item 89)

Box 2: Recommendations by the Council of the European Union for Germany

1. Public finances

- Implement the budgetary strategy for the year 2012 and beyond as envisaged and thus start reducing the level of debt (cf. Items 98 f.).
- Complete the implementation of the budgetary rule at the *Länder* level and further strengthen the corresponding monitoring and sanctioning mechanism (cf. Items 100 f.)
- 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 (cf. Items 102 and 130 f.).

2. Financial markets

- Address the structural weaknesses in the financial sector, in particular by restructuring Landesbanken (cf. Items 87 ff.).

3. Participation

Enhance participation in the labour market by:

- improving equitable access to education and training systems (cf. Items 122 ff.),
- reducing the high tax wedge in a budgetary neutral way (cf. Item 103),
- improving the incentives for people with low earnings prospects to take up work (cf. Item 116),
- increasing the number of fulltime childcare facilities and all-day schools (cf. Item 122),
- reviewing the measures to reduce tax disincentives for second income earners to work (cf. Item 103).

4. Competition

- Remove unjustified restrictions on certain professional services and on the craft sector (cf. Item 137).
- Improve competition in network industries (cf. Item 135 f.).
- Strengthen the supervisory role of the Federal Network Agency in the rail sector (cf. Item 135).
- Focus on improving the cost-effectiveness of the Renewable Energy Act, ensuring the effective independence of energy production and transmission (cf. Items 168 f. and 177).

46. If comprehensive prevention should prove inadequate, financial assistance to tackle a debt crisis must only be provided as a last resort, i.e. if the stability of the eurozone as a whole is at risk. That is a precondition for the European bailout mechanisms. The European Financial Stability Facility (EFSF) is designed to meet the current, short-term challenges and to prevent contagion in the eurozone. Its emergency aid is tied to strict conditions. The European Stability Mechanism (ESM) will commence operations as a permanent crisis mechanism in 2012. Its aid is tied even more strongly to conditions. For example, the ESM includes the participation of private-sector creditors in line with the principles and procedures of the IMF, as well as the anchoring of standardised and identical collective action clauses in all new government bonds from the euro currency area.

47. When individual states become insolvent, this can have a serious impact on banks. It is all the more crucial for the new system of rules for the financial players to be completed quickly – for greater financial stability, and thus also more stability in the real economy in the eurozone. In Germany, the financial supervisory authorities have had possibilities to force troubled banks to restructure. The European Commission is working on similar procedures for all member states. Germany is also a pioneer in the regulation of speculative transactions like short-selling and bond-based derivatives. The Federal Government also believes that a sound level of capital adequacy in banks of significance for the financial markets is important in order to restore lost confidence in the soundness of the banks and the performance of the financial markets, and thus to prevent impending disruption to refinancing possibilities and financial market stability. The Federal Government will be closely involved in the EU negotiations on the implementation of Basel III and will ensure that corporate financing is not impaired by the new rules.

48. It is necessary to prevent the rules for banks being bypassed by investors shifting their business to less regulated financial service providers. Administrators of hedge funds and other alternative investment funds, such as private equity funds, will in future be subject to uniform EU-wide licensing requirements and wide-ranging transparency and information requirements. Finally, the more highly regulated and supervised financial advice services for investors and small savers will help to strengthen confidence in the financial markets.

Continuing consolidation in a credible, sustainable and pro-growth manner

49. Confidence in the sustainability of fiscal policy in the member states is crucial if the eurozone crisis is to be overcome. Germany is, and will remain, an anchor of fiscal stability in the eurozone. The preconditions for this are in place: in 2009, Germany was the first country in the EU to anchor a debt brake in its constitution. It states that the Federation must present a budget which is close-to-balance in structural terms in 2016. The efforts en route to this are paying off: last year, Germany already clearly dropped below the deficit permissible according to the Maastricht criteria, at 1.0 percent of GDP. Germany thus met the provisions of the European deficit procedure two years earlier than required. This strengthens confidence and makes an important contribution towards perpetuating German growth.

50. The co-existence of sustainable consolidation and a pro-growth approach lies at the heart of German fiscal policy. The Federal Government is therefore setting deliberate priorities in its budget and orienting its expenditure more and more to investment in the future and to sustainable growth. This year, the Federation will probably invest 13.8 billion euro in research and development, following 13.7 billion euro last year.

Furthermore, the Federal Government will take advantage of every possibility to make the tax system fairer and to reduce the burden of taxes and charges. In the system of the progressive income tax tariff, the state profits from the fact that the tax system generates revenues from the effect of fiscal drag. These unintended taxes are to be countered by means of a correction to the income tax tariff. On 7 December 2011, the Federal Government adopted a corresponding bill. According to this, increased tax revenues caused by fiscal drag totalling roughly 6 billion euro will be cut in two steps, as of 1 January 2013 and 1 January 2014. The tax relief for individuals will be around 2 billion euro in 2013 and another 4 billion euro in 2014. A regular review of the effect of fiscal drag across the tax rates is to take place every two years from the 18th period of legislation.

Utilising people's skills and creativity

51. Germany's upturn in employment is the result of the responsible attitude of the parties to collective bargaining and of the successful post-crisis recovery. Germany's labour market has proved to be considerably more resilient than many international observers thought possible: in recent years, Germany has successfully reformed its system of basic allowances for jobseekers and of employment promotion, it has made its job placement services more efficient, it has reduced the entry barriers by opening up flexible forms of employment, and it has improved the overall functioning of the labour market. Further to this, the parties to collective bargaining have made the structures of their agreements more flexible. These measures are now paying off.

52. Participation in the world of work opens up fresh opportunities to people. For this reason, even more people who are unemployed today or are aiming to get a job need to be placed in work. The Federal Government will continue its policies to foster higher employment and growth. This includes encouraging even more people to take up a job. Jobs must offer people a long-term prospect.

53. With its concept to secure the availability of skilled workers, the Federal Government has taken an important step to actively tackle the impending skills shortage. It stresses the point that better use needs to be made of all the potential on the labour market in future and it lists the measures to improve the opportunities to participate on the labour market especially for women, older workers, the low-skilled, and people with a migrant background. Here, it is also important to increase the productivity of work via improved training and lifelong learning. So that even better use can be made in future of the experience of older workers, the Federal Government regards the gradual increase in the retirement age to 67 not least as a matter of economic necessity and sense.

54. In future, Germany will be increasingly reliant on the abilities and creativity of skilled workers from abroad. To a growing extent, the demand for skilled workers cannot be fully met by improving the training of the domestic population or by the freedom of move-ment for workers in the EU. Skilled immigrants strengthen the knowledge base in Germany and promote the integration of German commerce into the international division of labour. They create jobs and boost potential growth in Germany. In this way, they will help to ensure that the growing welfare burdens related to the swiftly changing age structure of the German population can be better handled.

The Federal Government has introduced a bill to make it much easier for people from outside the EU with skills to immigrate, to reduce the related bureaucracy, and to considerably improve the rules governing permission to live and work in Germany. The new rules orient the rules on residency for skilled workers more clearly to transparent, systematic and clear criteria, and are an important building block for an effective welcoming culture, which can help foster higher growth and prosperity in Germany.

Promoting competition, pleasure in innovation and openness to technology

55. Competition is the main driving force for innovation and growth. Over the last two decades, competition and advances in technology have made decisive contributions to boosting scope for growth in Germany. Growth policy therefore always involves a commitment to free markets and openness to technology. It creates the conditions for companies to invest in those fields which promise the greatest success.

56. For this reason, the Federal Government further improved the statutory framework for competition last year. Substantial progress was made in the energy and telecoms sectors in particular. The Federal Government will continue its competition-based policy in the grid-based industries. In particular, competition on the railways is to be strengthened further in Germany and Europe. The Federal Government intends to review the rules on competition in the postal sector.

57. Pleasure in innovation and free markets have made German companies – from small firms to traditional industrial concerns – so successful on the world's markets. The key point here is to provide the right environment for research and development – with the greatest possible openness to all technologies. The programmes to provide direct assistance to research are to be thoroughly and quickly evaluated. Also, the Federal Government advocates strong international patent protection and a rapid implementation of the EU patent.

58. An affordable and secure supply of raw materials and energy is the material basis for growth and prosperity. Last year, Germany embarked on a fresh chapter in its energy policy. The Energy Package marked an important step towards a long-term restructuring of energy supply towards more renewable energy. Germany wants to become one of the world's most energy-efficient and environmentally friendly economies, while at the same time enjoying affordable energy prices and a high level of prosperity.

If the supply of energy is to be affordable, renewable forms of energy need to be brought quickly to market conditions and survive in the face of competition. This is also important for their long-term acceptance by companies and consumers. A secure energy supply based on renewables also requires efficient infrastructure which meets the technical needs of the fluctuating quantities generated from renewable forms of energy. This primarily involves a resolute expansion of the grid infrastructure and electricity storage facilities at national and European level.

B. Making Europe a union of stability

Strengthening prevention – averting crises

59. Europe's successful integration stands for peace and prosperity. As part of the Europe 2020 strategy, the European states have set themselves a number of ambitious and important tasks that take a strategic approach to meeting the pressing economic, social and environmental issues facing Europe in the 21st century. The strategy objectives seek to promote social inclusion, enhance the future prospects of Europe's citizens, improve training and education opportunities and bolster Europe's innovative strength. Now, more than ever, the European community of states is called upon to collectively play an active role on the international stage to ensure that it can continue to successfully meet all of these challenges.

As a common currency, the euro is the logical and necessary continuation of the European integration process. The major benefits the common currency offers both consumers and enterprises have been proven in Germany and in Europe as a whole (cf. GCEE Annual Report, Item 39). The debt crises in individual European states demonstrate that these benefits can only be secured for the long term through greater European integration and increased stability. Europe must become a union of stability, with shared values, credible rules and clear sanctions. To this end, all parties must recognise that the success of a common currency area hinges upon an individual sense of responsibility and a willingness to adapt among all member states. On the other hand, abandoning currency union would not solve the problems in the individual countries experiencing these crises or in the eurozone as a whole – indeed, this view is echoed by the German Council of Economic Experts (cf. GCEE Annual Report, Items 154 ff. and 162 ff.).

60. The Federal Government will be actively involved in taking the necessary steps to increase stability and sustainable growth in Europe in an economically responsible manner. Significant progress has already been made by the European Union in this direction (cf. Box 3). The focus here is on prevention (cf. Overview 2). A new eco-

Overview 2: Key elements of collaboration on economic policy issues in the European Union

GOAL

Reduce national debt	Strengthening growth and competitiveness	Stabilising the financial market

CRISIS PREVENTION

New fiscal pact and Stability and Growth Pact
- → Debt brakes in all eurozone countries
- → Additional target in tandem with the 3 percent deficit limit – a balanced budget is a requirement in the medium term and is backed by sanctions
- → Mandatory debt reduction (reducing the difference between the debt level and the reference value of 60 percent of GDP) by $^{1}/_{20}$ per year)
- → Automatic sanctions in the event of non-compliance

Europe 2020
- → Joint strategy for intelligent, sustainable, and inclusive growth

Mechanisms for monitoring macroeconomic imbalances
- → Early detection of bubbles and imbalances and policy guidelines to correct these (with sanctions) where necessary

Euro Plus Pact
- → Eurozone countries agree on annual targets to boost competitiveness

Financial market reform
- → New EU financial market supervision (at macro and micro levels)
- → EU-wide, coordinated stress testing
- → Stricter regulation (more equity financing, less speculative products)
- → National regulations on bank resolution & national funds for bank restructuring

CRISIS AID

European Stability Mechanism (ESM)
Permanent **"protection mechanism" as of 2012**
Financial aid packages are granted subject to strict conditions to safeguard financial stability in the eurozone

European Financial Stability Facility (EFSF)
Temporary **"rescue fund" until 2013**
Financial aid packages are granted subject to strict conditions to safeguard financial stability in the eurozone

nomic and fiscal constitution for the eurozone must be based on the principles of subsidiarity, individual responsibility and liability that have worked well in the Social Market Economy. This is the only way that Europe can hope to learn from past mistakes and become a true union of stability.

Box 3: Key resolutions and measures in the eurozone since the start of 2010

Informal European Council (11 February 2010)
- EU 2020 Strategy agreed.
- The heads of state and government of the European Union pledge political support to Greece. They agree that measures will be taken, if necessary, to secure the financial stability of the eurozone.

European Council (25/26 March 2010)
- The Council agrees that it is willing, in principle, to provide financial aid to Greece to secure financial stability and safeguard the common currency.
- If sufficient capital market financing cannot be secured, bilateral loans are to be granted in conjunction with the IMF, subject to strict conditions and without any subsidy element.

Special Summit on the Eurozone (7 May 2010)
- The heads of state and government of the eurozone countries agree on a financial aid package for Greece.

ECOFIN Council (9 May 2010)
- Agreement is reached on a European rescue fund (EFSF/EFSM) worth a total of 500 billion euro.

ECOFIN Council (8 June 2010)
- The European Semester process is agreed.

European Council (16/17 December 2010)
- The heads of state and government of the EU approve the EU Treaty amendment (TFEU, Article 136) that is required to establish the European Stability Mechanism (ESM) and agree on the basic features of this mechanism.

Meeting of the European Member States (11 March 2011)
- The member states agree to a Euro Plus Pact to foster competitiveness within the European Union and to strengthen economic and monetary union.
- Key points of the EFSF and ESM are also agreed.

ECOFIN Council (15 March 2011)
- The Council agrees on a package of legislative measures (referred to as the *six-pack*) to reinforce financial and economic governance in the EU.

Meeting of the Euro Group (21 March 2011)
- The Group approves key points of the ESM.

European Council (24/25 March 2011)
- Resolutions are passed on the Euro Plus pact, *six-pack* and ESM.

Meeting of the Euro Group (21 July 2011)
- The heads of state and government agree to extend the terms of and reduce the interest on the financial assistance provided by the EFSF.

- They also agree on additional instruments for the EFSF (and later the ESM) to lend greater flexibility to these mechanisms.
- A second financial aid package is approved for Greece.

European Parliament (28 September 2011)
- The *six-pack* is approved by the European Parliament

German Bundestag (29 September 2011)
- The Bundestag approves an amendment to the German act on accepting guarantees within the framework of a European Stability Mechanism to expand the role of the EFSF.

European Council and Eurozone Summit (26 October 2011)
- Italy's plans to reform its finances with a view to budget consolidation and increased competitiveness are welcomed.
- Agreements are reached on the coordination and supervision of economic and budgetary policies.
- Debt brakes are introduced in all eurozone countries at the constitutional or equivalent level.
- It is agreed that the European Commission is to be consulted on all plans to reform economic and budgetary policies that could potentially affect other member states.
- Draft budgets of individual member states are to be reviewed by the European Council and the European Commission within the context of the excessive deficit procedure.
- Private bondholders of Greek government bonds agree to a 50 percent haircut on the value of debt outstanding.
- Optimisation of the EFSF's lending capacity
- Regular meetings of the heads of state and government of the eurozone countries

ECOFIN Council (8 November 2011)
- The *six-pack* is formally approved by the Council.
- The Council adopts conclusions on an early-warning scoreboard to be used as part of the new mechanism for the surveillance of macroeconomic imbalances.

European Council and Eurozone Summit (8/9 December 2011)
- An economic and fiscal stability union is established, with the objectives of ensuring budgetary discipline and a deeper level of integration of the single market, in addition to fostering growth, greater competitiveness and enhanced social cohesion.
- An intergovernmental treaty is concluded between the 17 eurozone states and other EU member states on a new fiscal pact.
- National debt brakes are to be implemented in accordance with European guidelines and the European Court of Justice is granted the authority to pass judgement on the compliance of national debt brakes with these guidelines.
- It is agreed that the EU will, in future, be entitled to impose more automatic correction mechanisms on countries in the excessive deficit procedure.
- Member states currently undergoing an excessive deficit procedure must enter into a reform partnership for structural reform. Implementation of this partnership is to be reviewed by the European Commission and the European Council.
- The one-twentieth rule specified in the Stability and Growth Pact, whereby member states are required to reduce the difference between their current debt levels and the upper limit of 60 percent of GDP by one-twentieth each year, is to be enshrined in a treaty.
- It is agreed that the ESM will begin its work in July 2010, one year earlier than planned.

Setting a fixed timetable – the European Semester

61. The European Semester maps out a binding timetable for the monitoring of economic, employment and fiscal policy in Europe. The European Semester runs in parallel with the Europe 2020 process, the Stability and Growth Pact and the new mechanism for monitoring macroeconomic imbalances (cf. Box 4). The European Semester consists of a six-month cycle starting in January each year.

62. The Federal Government welcomes and supports the European Semester process as a means of improving the monitoring of economic, employment and fiscal policy at European level. However, it believes that the recommendations made as part of the European Semester must be more directly targeted at the member states that are experiencing significant problems with economic, employment and fiscal policy in order to ensure more effective prevention of future crises. National recommendations approved by the European Council must be implemented more resolutely than has been the case to date. It is therefore particularly welcome that the new procedure for monitoring macroeconomic imbalances will form part of the European Semester as of this year. The Federal Government is also of the opinion that the ambitious timetable for the European Semester should be extended to ensure thorough and effective multilateral monitoring.

Greater competitiveness in Europe as a whole – monitoring macroeconomic imbalances

63. The lack of competitiveness in certain member states was a major trigger for the loss of confidence in a stable economic and financial development in these countries. It is therefore appropriate that the monitoring of macroeconomic imbalances and competitive-

Box 4: The European Semester

The introduction of a European Semester was agreed by the European Council of the heads of state and government in June 2010 and the first cycle began in the first half of 2011. The schedule for this year's European Semester is set out below:

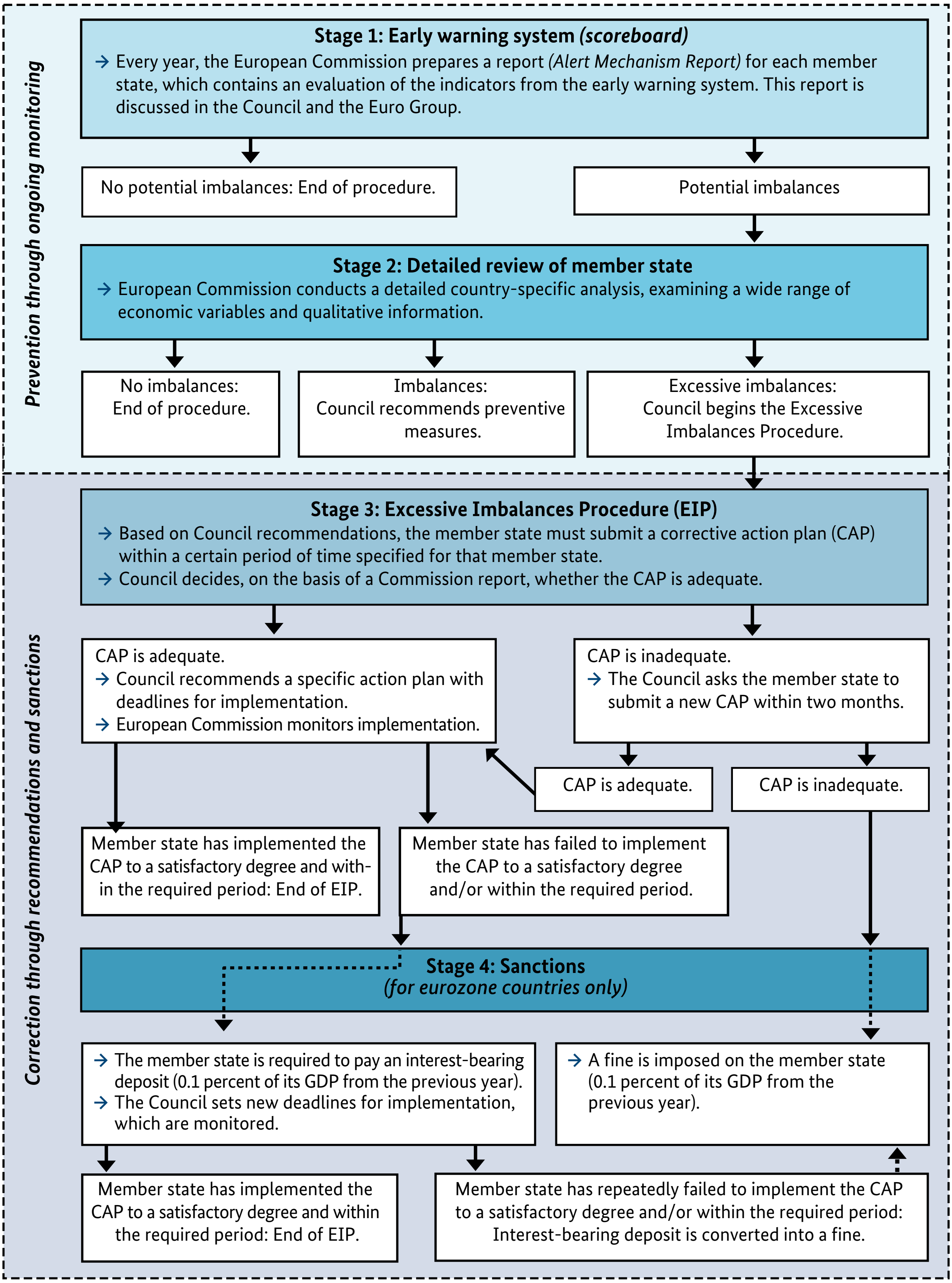
1. In November 2011, the European Commission presented its *Annual Growth Survey 2012*, setting out the greatest challenges for economic, employment and fiscal policy, and proposing solutions for dealing with these challenges. This survey focused on implementation of the measures already agreed for stabilising the debt crisis in the eurozone, with a particular emphasis on boosting growth. According to the European Commission, the following objectives are vital at both European and national level:
   - Achieve fiscal consolidation to promote growth
   - Restore normal lending by banks
   - Strengthen growth and competitiveness in a sustainable way
   - Stem unemployment and the social consequences of the crisis
   - Modernise public administration

2. In April 2012, the member states will submit their *Stability and Convergence Programmes* and their *National Reform Programmes* to Brussels for review. The *Stability and Convergence Programmes* focus on fiscal policy development. Meanwhile, the national reform programmes represent the structural policy agendas of the member states and also incorporate the voluntary commitments made as part of the Euro Plus Pact.

3. Based on its review of these programmes, the European Commission will make *country-specific recommendations* as to how the member states can meet the unique challenges they face (Box 2).

4. The second European Semester will draw to a close when the *country-specific recommendations* are approved by the heads of state and government at the European Council in the middle of 2012.

Overview 3: The new EU procedure for monitoring and correcting macroeconomic imbalances



Box 5: EU procedure for avoiding and correcting macroeconomic imbalances: Indicators and threshold values in the early-warning system in 2011

The procedure is based on an early-warning system (known as the *scoreboard*), which is based on the following measurable criteria (cf. Figure 5):

Indicators for detecting external imbalances
- Current-account balance: +6 percent/-4 percent (average over three years, based on GDP)
- Net international investment position: -35 percent of GDP
- Export market shares (five-year change): -6 percent
- Nominal unit labour costs (three-year change): +9 percent for eurozone countries; +12 percent for non-eurozone countries
- Real effective exchange rate (three-year change): +/-5 percent for eurozone countries; +/-11 percent for non-eurozone countries

Indicators for detecting internal imbalances
- Private sector debt (in relation to GDP): 160 percent
- Public sector debt (in relation to GDP; this indicator is normally examined in conjunction with private sector debt): 60 percent
- Lending to the private sector (in relation to GDP): 15 percent
- House-price index (change on the previous year, based on the consumer-price increase): +6 percent
- Unemployment rate (three-year average): 10 percent

ness in the member states will play a prominent role in the EU from now on. To this end, a new procedure for avoiding and correcting macroeconomic imbalances was introduced, in parallel with the surveillance of fiscal policy under the framework of the Stability and Growth Pact (cf. Overview 3). The new procedure is intended to help prevent future crises by enabling the early detection of undesirable economic trends or competitive weaknesses, which could threaten stability in the eurozone. It is also designed to correct these imbalances, using sanctions where necessary.

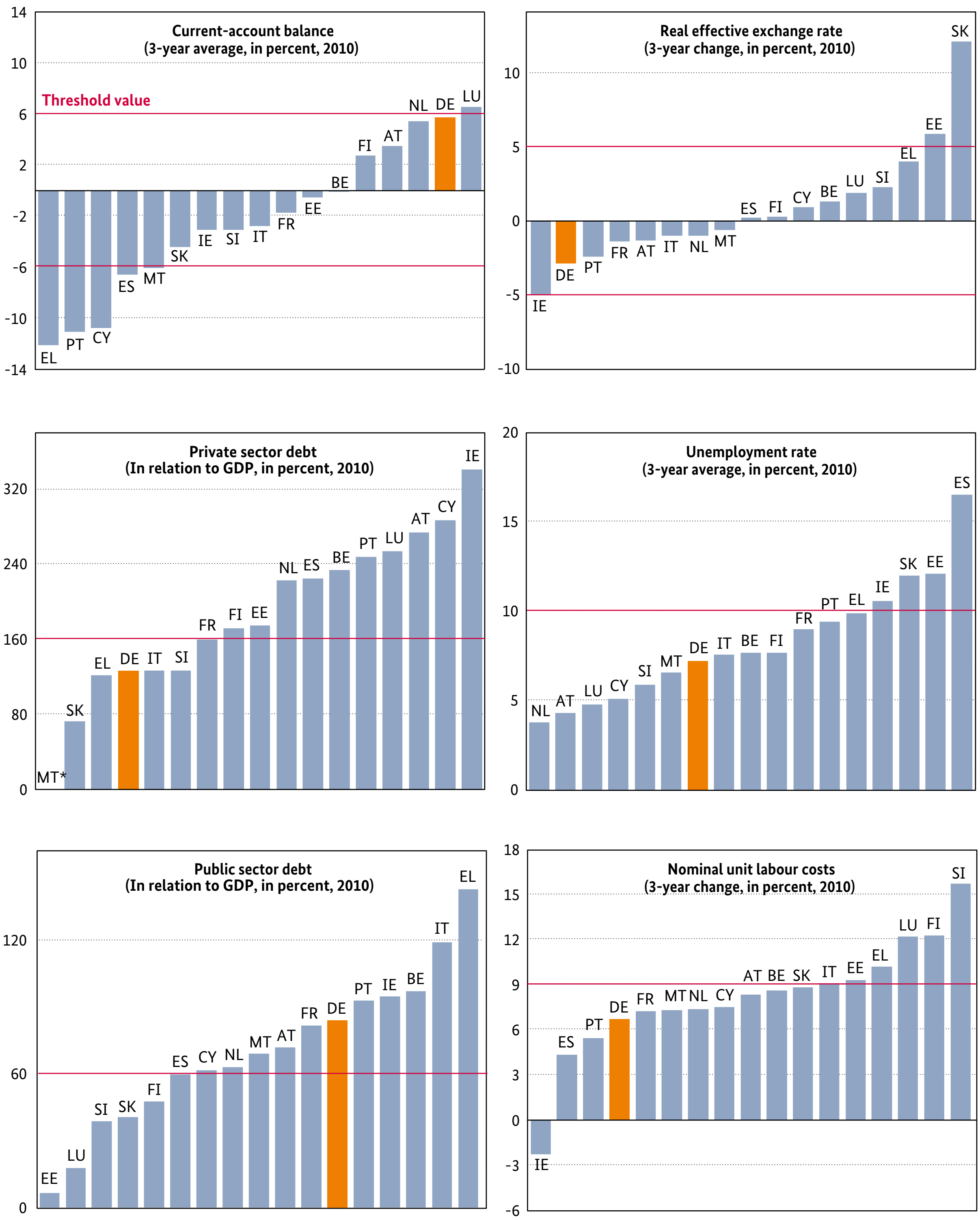
64. The procedure is aimed in particular at countries experiencing weaknesses in their competitiveness, which find particular expression as high current-account deficits (cf. Box 5). This is explained as follows: first, countries in this situation are much more likely to have an impact on other member states than are competitive countries with current-account surpluses. Second, current-account deficits generally go hand-in-hand with rising levels of external debt, thus weakening the solvency of the affected member states and in turn the viability of the eurozone. The Federal Government therefore welcomes the clarification provided by the European Commission that current-account surpluses will not incur sanctions in this procedure. These surpluses are justified if, as in Germany, they result from competitive enterprises in viable markets and are related to structural conditions that determine the rate of savings and investments.

Creating confidence in sound fiscal policy through a stability union

65. To safeguard the long-term viability of the public finances in all member states, the community has put much stricter requirements in place for national fiscal policies. This boosts confidence in a sound budgetary policy and therefore also enhances the opportunities for growth in all eurozone countries. The progress made towards consolidating public budgets in Germany and a number of other eurozone countries demonstrates that a credible programme of savings measures enables a swift return to solid public finances, while also promoting growth (cf. GCEE Annual Report, Items 98 ff.).

66. A package of European regulations (known as the *six-pack*) has significantly tightened the rules set out by the European Stability and Growth Pact:

Figure 5: Selected indicators and threshold values in the early warning system



* Data not available.

Source: European Commission

– Member states are now obliged to pursue a cautious budgetary policy to achieve the medium-term objective of a budgetary position of close to balance. The preventive measures outlined in the Stability and Growth Pact have taken on a greater significance in this context.

– The debt limit of 60 percent of GDP is now subject to greater scrutiny than ever before, as member states are obliged to gradually reduce excessive debt ratios. In addition, sanctions may be imposed if this reduction takes too long to complete.

– Certain minimum standards have also been established for the budgetary and fiscal policy frameworks of the member states.

– The reduction of both deficit levels and debt ratios is subject to a new, graduated system of sanctions, which means that sanctions can be applied at an earlier stage in future. Sanctions may also be imposed on a majority of eurozone countries if this measure is proposed by the European Commission.

– In future, the recording of data relating to deficits and debts will be more independent and standardised, and will be monitored more closely by Eurostat. Fines will be imposed where statistics are found to have been falsified.

67. At the summit meeting on 8/9 December 2011, the heads of state and government agreed that these measures should be supplemented and extended in a meaningful way. In addition, an intergovernmental treaty between the eurozone countries and nine (final figure to be confirmed) other EU member states will establish a fiscal stability union, which will pave the way for a new level of coordination and integration. Specifically, the following points were agreed:

– Following the example of Germany's debt brake, which is enshrined in its Constitution, the eurozone countries have made a commitment to introduce a national budgetary rule for a balanced budget at constitutional or equivalent level. All countries in the eurozone will use these rules to set themselves credible short-term and long-term budgetary targets. This means that governments will be required to justify their fiscal policies both at European level and to the highest legal authority in their country. This also lends credibility and conviction to the necessary measures that must be taken to consolidate and reform national budgets, while sending a clear message to consumers, enterprises and financial markets alike that governments are pursuing a healthy budgetary policy.

– In future, the annual, cyclically adjusted deficit must not exceed 0.5 percent of gross domestic product (GDP). Member states that are unable to apply the budgetary rule immediately are required to set out the steps they plan to take to reach the specified target in the medium term. The European Court of Justice has the power to review the implementation of this budgetary rule in national law.

– Preventive monitoring of national budgetary policies is to be stepped up significantly. This goes so far as to entitle the European Commission to demand that a member state submit a new budget if the existing budget is deemed to contain serious violations of the stipulations of the Growth and Stability Pact.

– The corrective arm of the Stability and Growth Pact has also been strengthened. Member states undergoing a deficit procedure must commit to implementing detailed consolidation and correction measures as part of a reform partnership. Implementation of these measures will be monitored by the European Commission and the Council of the European Union.

– In future, the EU will have the power to impose more automatic correction mechanisms and sanctions on countries in the deficit procedure. Recommendations made by the European Commission within the context of a deficit procedure can only be overturned by a qualified majority of eurozone states. A reverse qualified majority applies in this case. The German Council of Economic Experts also points out that steps need to be taken to further strengthen the independence of the decisions made within the framework of the Stability and Growth Pact (cf. GCEE Annual Report, Item 208). It advocates that the European Commission must be given additional powers as a decision-maker in the deficit procedure.

– In addition, the one-twentieth rule specified in the revised Stability and Growth Pact, whereby member states are required to reduce the difference between their current debt levels and the upper limit of 60 percent of GDP by one-twentieth each year, is to be enshrined in a treaty.

68. The intergovernmental treaty that includes the essential measures is to be signed by the end of March 2012. Once ratified by the member states, it will make the new economic and fiscal stability union a reality. The heads of state and government of Bulgaria, the Czech Republic, Denmark, Hungary, Latvia, Lithuania, Poland, Romania and Sweden have already signalled that their countries are ready to become part of this union – following consultation with their parliaments if necessary. This clearly indicates that Europe as a whole is fully committed to tackling the crisis. It is also fully committed to incorporating this treaty into the legal framework of the EU as soon as possible (although this is not currently an option because of the position taken by the United Kingdom).

Seizing the initiative – the Euro Plus Pact

69. In March 2011, the eurozone countries signed the Euro Plus Pact. This plan was initiated by Germany and France and represents another driver of growth and competitiveness in Europe. It envisages that the heads of state and government of each participating country will make a commitment to all other participating countries to reach certain targets and implement specific measures. This intention is to boost competitiveness, raise employment levels, improve the long-term sustainability of public finances and reinforce financial stability. Choosing specific targets and measures to implement in these areas remains the responsibility of the individual states. This means that the participating states can deliberately sharpen their focus on certain challenges.

70. The Pact is also open to other EU member states. Six countries from outside the eurozone have already joined: Bulgaria, Denmark, Latvia, Lithuania, Poland and Romania. The Federal Government welcomes the fact that the states participating in the Pact have committed to a total of more than 100 measures in the first year, which are to be implemented within the space of one year. Germany has itself agreed to 22 measures (cf. Box 1).

The Euro Plus Pact can only succeed in adding real value to the existing coordination process if the implementation of these measures is monitored consistently and if progress is critically examined at the highest political levels. The Federal Government is deeply committed to ensuring that this goal is achieved.

Emergency assistance only as a last resort

In mid-2010, the EU member states established two stability mechanisms to tackle the current debt crises in individual countries and to prevent these crises from affecting the financial and real economic stability of the entire eurozone. The temporary *European Financial Stability Facility* (EFSF) will eventually be replaced by the permanent *European Stability Mechanism* (ESM). The ESM will begin operating as early as 2012 (cf. Overview 4).

71. The set of instruments that comprise the EFSF was extended in order to meet the problems at hand. Originally established for the purpose of providing conventional loans, the EFSF now also has the power to buy government bonds on primary and secondary markets, grant contingent credit lines and provide loans to states for recapitalising financial institutions. These additional powers place the EFSF in a stronger position to counteract the risk of debt crises spreading within the financial sector. The same instruments will also be available to the ESM.

72. To maximise the firepower of the EFSF instruments, the eurozone countries have agreed on two models for optimising the available resources. The first consists of partial risk protection for new government bonds, which will cover between 20 percent and 30 percent of potential losses, while the second will entail establishing one or more co-investment funds for primary and secondary market interventions.

73. However, these emergency assistance measures cannot replace structural reforms and changes to the real economy. For this reason, they must be subject to requirements, including obligatory reforms to structural and budgetary policies. The Federal Government has successfully campaigned for such restrictions to be put in place. Emergency assistance can only be granted if the recipient country implements a strict

restructuring programme. No decisions can be taken against the vote of Germany.

74. Confidence in the stability of the eurozone can only be regained if public participation and involvement is guaranteed in all key decisions about the future of the currency union. In Germany, the decision-making authority of the Bundestag is one means of ensuring national autonomy in this context. A tiered system of participation rights applies to the instruments of the EFSF, whereby issues of particular importance, such as decisions on the granting of assistance or treaty changes, must be approved by a plenary session of the Bundestag, while decisions of less national import can be taken by the Budget Committee.

75. The ESM is scheduled for deployment as of mid-2012. From mid-2013, it will assume all of the tasks of the temporary EFSF. One major difference between the two rescue funds is that ESM members are required to introduce standardised debt restructuring clauses (known as collective action clauses, or CACs) for all new government bonds with a term of more than one year. These clauses specify majority and other collective action provisions that will apply in cases where discussions about debt restructuring are unavoidable. This fulfils a key prerequisite for establishing a regulated system of private sector involvement. From the outset of negotiations on the ESM, the Federal Government has urged that the principle of linking risk directly to liability (a principle that is core to a market economy) must be incorporated in the design of the ESM.

76. In practice, the precise nature and extent of this participation will be based on the principles and procedures of the IMF and will be determined on a case-by-case basis. The IMF will make its financial assistance packages dependent on private sector participation if an adjustment programme (consolidation, structural reform) and public financing fail to deliver realistic prospects of restoring a country's debt sustainability.

77. The German Council of Economic Experts proposes a regulatory framework for the drawing-down of ESM loans, which is based on the public debt ratio of each country (cf. GCEE Annual Report, Item 245 f.). Member states with debt levels up to 60 percent of gross domestic product are to be granted full access to ESM loans.

Overview 4: Overview of the EFSF and ESM

	EFSF	ESM
Legal basis	Private law	International treaty
Lending capacity	440 billion euro	500 billion euro
Coverage	Total guarantee commitments: 780 billion euro (plus interest) To ensure an AAA rating for the EFSF, the guarantees exceed the lending capacity.	Subscribed capital: 700 billion euro (of which, 80 billion euro is paid-in capital and 620 billion euro is callable capital) To ensure an AAA rating for the EFSF, the guarantees exceed the lending capacity.
German contribution towards guarantees	German guarantee: 211 billion euro	German contribution: To paid-in capital: 22 billion euro To callable capital: 168 billion euro (in the form of guarantees in the federal budget)
Instruments	Loans, contingent credit lines, primary market purchases, secondary market purchases, loans for the recapitalisation of financial institutions	
Prerequisites for receiving assistance	– The stability of the entire eurozone must be at risk. – An application must be submitted by the member state.	– The stability of the entire eurozone must be at risk. – An application must be submitted by the member state. – Private-sector involvement in accordance with the principles and procedures of the IMF
Conditions for approving the granting of assistance	Fulfilment of strict requirements (such as the implementation of a macroeconomic correction plan, sector-specific requirements)	
Decision-making process	A unanimous agreement must be reached between the eurozone countries in the case of important decisions (such as financial assistance, interest rates, instruments to be applied, requirements, payment of instalments). At their meeting on 8/9 December 2011, the heads of state and government of the eurozone countries agreed to introduce a special procedure whereby urgent decisions can be taken with a qualified majority of 85 percent.	

For debt levels between 60 and 90 percent, the granting of loans will be subject to the implementation of an adjustment programme, to run for several years. If debt levels exceed 90 percent, loans will require the participation of private sector creditors.

The Federal Government believes that strict conditions (conditionality) must always apply to the granting of financial aid from the ESM. Differentiation based on fixed national debt thresholds does not appear appropriate, since it does not take sufficient account of the unique circumstances of each individual case. The Federal Government will continue to maintain its current position on this issue in negotiations on the ESM.

78. Both the Federal Government and the German Council of Economic Experts reject the idea of eurobonds (cf. GCEE Annual Report, Items 173 ff.). The Council rightly points out that eurobonds would under-mine market discipline in the eurozone. The Federal Government always seeks to promote independent efforts towards maintaining economic stability among the member states of the EU. The concept of eurobonds would also run counter to this objective in the longer term.

79. The Council of Economic Experts proposes the idea of setting up a *debt redemption pact* in connection with national debt brakes if the stabilisation measures already agreed prove to be inadequate (cf. GCEE Annual Report, Items 184 ff.). In all cases where the national debt of any member states in the eurozone (including Germany, France and Italy) exceeds the Maastricht threshold of 60 percent of GDP, the debt would be transferred to a debt redemption fund. This would correspond to a total of well over 2.3 billion euro. In each case, the individual member state transferring the debt would continue to bear primary liability for its debts, while secondary liability would be borne by the redemption fund. The participating member states would have joint liability for the fund as a whole. They would be obliged to redeem the debt they transfer to the redemption fund over a period of 20 to 25 years in order to keep their debt levels at or below 60 percent of GDP.

The Federal Government also advocates the introduction of national debt brakes. However, it is strongly opposed to the communitisation of debt. Such a move could have a significant impact on incentives for consolidation in all countries. It would lead not only to a massive increase in the amount of debt guaranteed by Germany, but also to a situation where Germany would be required to pay disproportionately high interest rates. Moreover, the currency reserves required for such a project cannot be made available by the German Central Bank. Finally, the Council of Economic Experts points out that policy should, for the time being, focus on the steps that have already been mapped out.

Adjustment and restructuring programmes – the necessity of national efforts

80. Financial aid serves only to treat the symptoms of national debt crises. However, in order to stabilise the eurozone as a whole, financial aid packages have been granted to Greece, Ireland and Portugal subject to strict conditions and in line with the specific problems facing each of these countries (cf. Box 6). This assistance allows these countries to buy some time in order to overcome their competitive weaknesses through consistent and appropriate reforms and to restructure their national budgets.

Box 6: From the 2008 financial crisis to the 2011 debt crisis

General rise in national debt levels in Europe

At the start of the financial crisis of 2008, the economic downturn and the associated repricing of risk in the private sector led to loan defaults and price adjustments. When US investment bank Lehman Brothers filed for bankruptcy, confidence in the financial system evaporated, resulting in a major deterioration in the condition of bank balance sheets and plummeting stock-market values. This situation necessitated state intervention to prevent the collapse of many financial institutions. National debt levels began to rise significantly in some European countries, in particular as a result of shortfalls in state revenue brought about by the economic downturn coupled with significant increases in state spending as part of extensive economic and growth programmes. However, the effects were felt very differently in each country (cf. Figure 6).

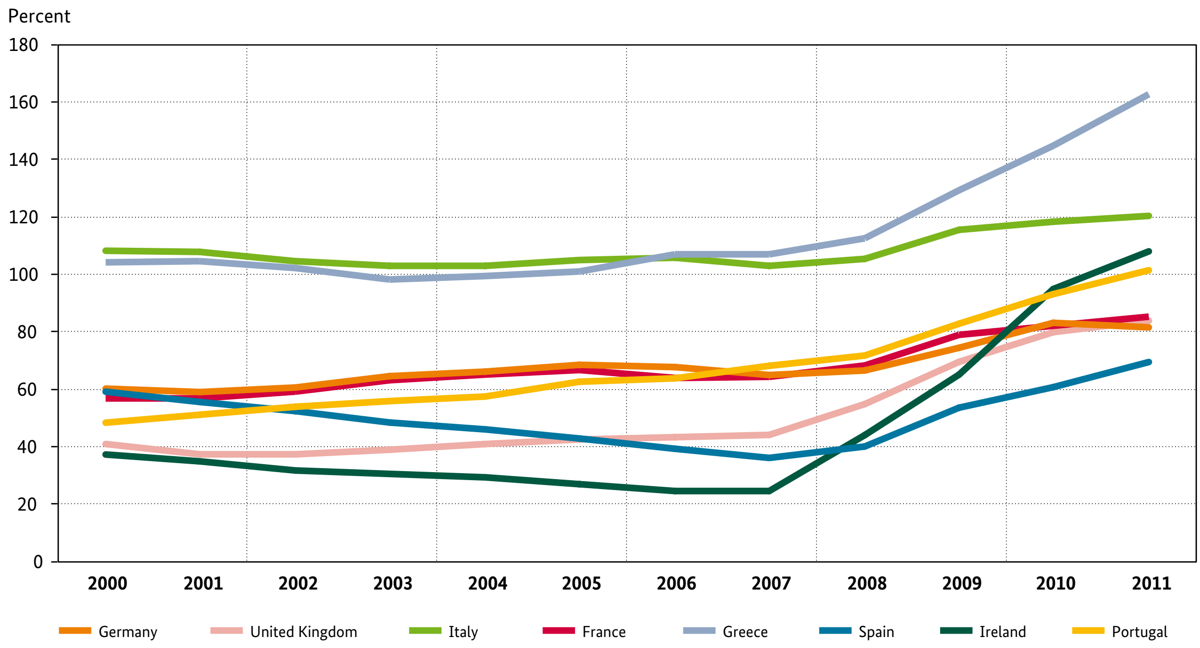
Contributing to the debt crises – a lack of competitiveness

The rise in national debt levels is particularly high in the eurozone countries that were drawn into the debt crisis in 2011, even where the debt level had initially been low before the onset of the crisis. This is the case, for example, in Ireland. A distinguishing feature of these countries is that they had notably failed to focus on the diversification and competitiveness of the national economy (cf. Figure 7). In these countries, the introduction of the euro caused interest rate levels to drop significantly. This decrease provided an opportunity to strengthen the competitiveness and diversification of the real economy through corporate investment. In reality, however, a considerable amount of investment capital was instead channelled into a very limited number of sectors, such as the property sector. National economic policy failed to take appropriate measures to counteract this trend. At European level, there was a lack of effective policy monitoring and early detection of these growing deficits in competitiveness. This failure aggravated the situation.

Limiting the risk of contagion

To track the developments that led to the critical escalation of the European debt crisis that occurred in 2011, we must look once again to the European financial sector. Essentially, many banks made considerable progress in the aftermath of the global financial crisis of 2008 and were particularly successful in building up their equity. Major improvements were also made to the regulatory environment. However, government bonds represent an extremely important and typically safe class of assets, which plays an especially significant role in a bank's balance sheet. The government debt crisis made it apparent that efforts to limit the risks of contagion in the European banking system would have to be further intensified if the spillover effects on the real economy were to be minimised. Against this backdrop, the European Council agreed to demand that large banks implement a significant increase in capital buffers on a temporary basis and to enhance the scope of the EFSF rescue system so that, for example, loans could be provided to member states for the purpose of propping up distressed banks. These measures, which are explicitly supported by the German Council of Economic Experts in its Annual Report, seek to ensure an effective restriction of contagion risks in the banking system. Clearly, further improvements must also be made to the regulation of the banking and financial sector in future.

Figure 6: National debt in Europe as a percentage of gross domestic product



Source: European Commission

81. Countries can regain the confidence of the financial markets by implementing consistent reforms, for example, in relation to the employment and product markets, and by pursuing sound budgetary policies. The German Council of Economic Experts highlights the particular efforts made towards consolidation in Greece, Ireland, Portugal and Spain (cf. GCEE Annual Report, Item 137). Ireland in particular has made impressive progress implementing the necessary measures in the areas of public finances, the financial sector and the structural reform agenda.

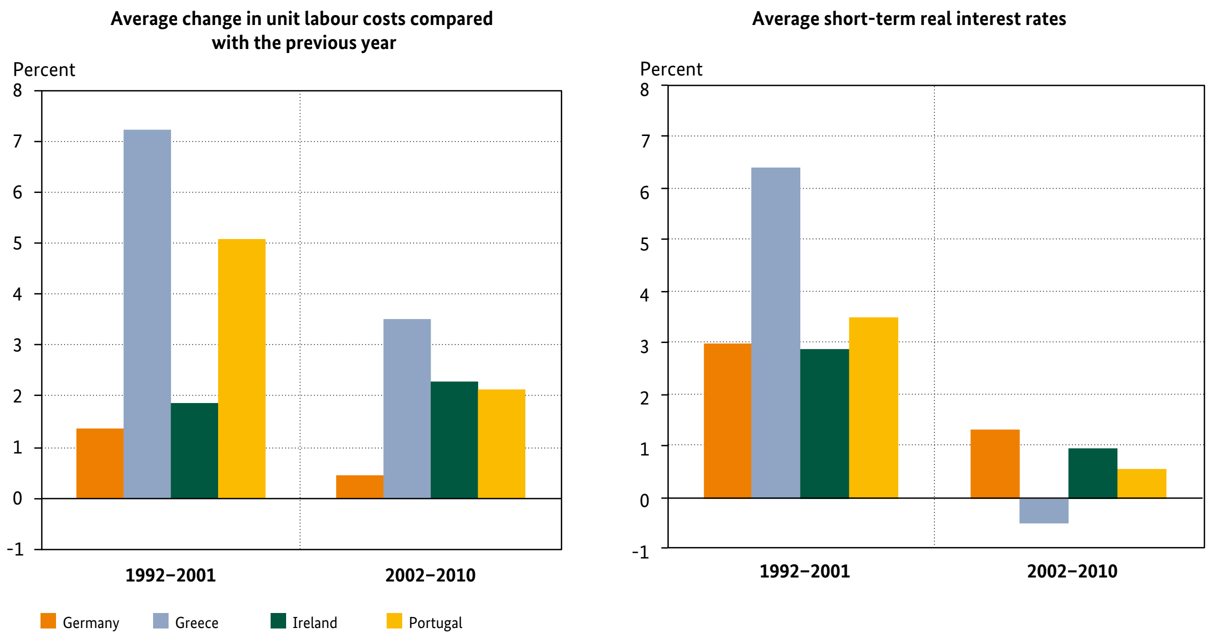
82. Within the framework of an adjustment programme that will extend over several years, Greece is to continue receiving bilateral financial assistance from eurozone member states and the IMF, who have disbursed 73 billion euro to date. Private creditors are also to participate in a new programme, in which the eurozone contribution will, in future, be financed by the EFSF. These creditors will make a substantial voluntary contribution to the fund by waiving half of their claims. Since 2010, an ambitious programme of budgetary consolidation has been accompanied by a raft of structural reforms, including pension reform, labour market reforms, a wage freeze that includes public sector wages, a reform of local government administration and tax administration, as well as the liberalisation of closed professions.

Greece in particular must establish an economic policy framework that is favourable to securing fresh investment and sustainable growth. It was with this objective in mind that the Federal Government launched the *Investment and Growth Initiative for Greece* in July of last year. One aim of this initiative is to provide technical assistance in the establishment of competitive structures, the modernisation of the Greek administration and the privatisation of state assets. In this way, the Federal Government seeks to help Greece implement extensive economic and administrative reforms to enhance the viability of Greek markets and create more scope for entrepreneurial initiative.

Towards a new culture of stability in financial markets

83. One lesson to be drawn from the renewed crisis of confidence in the European banking system is that consolidating national budgets in Europe is only the first step. Financial markets must also be further stabi-

Figure 7: Development of unit labour costs and real interest rates in Europe



Nominal unit labour costs for the economy as a whole; short-term real interest rates, usually 3-month interbank rates, adjusted for price changes based on the price index of private consumer spending

Source: European Commission

lised. Stabilisation is not an end in itself, but a prerequisite for rebuilding and maintaining confidence in savings. Without this confidence, a stable economic cycle is simply not possible. The Federal Government is therefore committed to reducing risks posed to stability across the board. All financial institutions and instruments that could give rise to stability risks must be appropriately regulated and supervised.

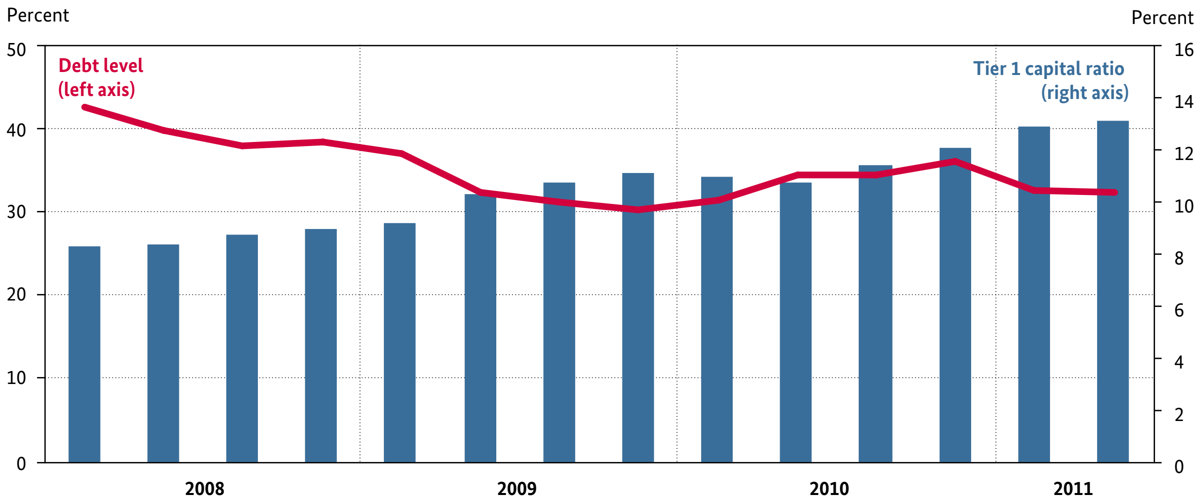
Higher capital requirements and liquidity to ensure stability

84. In future, banks will need to meet higher requirements in terms of capital and liquidity. These requirements are part of the *Basel III* set of reform measures on bank regulation. They will increase the resilience of banks in the face of macroeconomic crises and ordinary market risks. Two other issues currently under examination are a): which regulations can be implemented to restrict the ratio between the banks' transaction volumes and equity capital (leverage ratio) and b) what measures can be taken to ensure that a bank has access to funds even in times of financial distress. The German Council of Economic Experts recommends that the total assets of a financial institution must not be more than 20 times its Tier 1 capital (cf. GCEE Annual Report, Items 22 and 290 – 294). In international circles *(Basel III)*, discussions are currently focusing on a ratio in the order of 33 times the Tier 1 capital; however, the effects of this particular ratio would need to be monitored over a period of several years. In July 2011, the EU Commission submitted several legislative proposals on this topic, also emphasising the need for extensive analysis during a trial period. Such a trial period should be used to determine a debt-equity ratio that would create genuine stability, without unduly affecting financing of the real economy.

The *Basel III* measures for strengthening the capital base are based on a medium-term concept, with transitional periods spanning several years. It is imperative that these *Basel III* measures are simultaneously implemented in all of the key international financial centres (cf. Figure 8).

The German Council of Economic Experts has called for banks to underpin future loans from EU government bonds in their balance sheets with equity capital, in line with the applicable risk. As a result, these investment vehicles would no longer be treated more favourably than other government bonds, enterprise borrowing and other securities (cf. GCEE Annual Report, Items 248 and 249). The issue has been identified by the Federal Government for evaluation in the medium term.

Figure 8: Debt levels and Tier 1 capital of major German banks



The chart shows the performance of 13 large, internationally active German banks that did not transfer positions to resolution agencies during the period under review.
Debt level: Total assets/Tier 1 capital; Tier 1 capital ratio: Tier 1 capital/risk-weighted assets.

Source: Deutsche Bundesbank

85. The Federal Government will follow the EU negotiations on implementing *Basel III* very closely, and ensure that lending to businesses is not compromised by the new requirements. Furthermore, the Federal Government will insist that requirements imposed on banks are appropriate and carefully targeted. In particular, excessive and/or unnecessary burdens must not be placed on medium-sized banks. A simplified set of requirements should apply to smaller institutions operating in the conventional investment and loan business sector, provided this is feasible in terms of financial supervision.

86. The *Solvency II* regime is implementing far-reaching reforms within insurance regulation in the EU. This regime is modernising provisions on equity capital and risk management for insurance companies. These companies must, for example, underpin their investment risks with their own capital. In addition, the regime has brought about greater cooperation between the supervisory colleges and better oversight of insurance groups. The Federal Government plans to implement the EU framework directive *Solvency II* into national law, within the specified timeframe. Two more pieces of legislation required to complete the project are currently under discussion at European level.

Crisis-proofing banks of systemic importance

87. Particularly strict rules must apply where banks are especially large or otherwise play a key role within the financial system. They are to cover themselves with additional equity capital in future. The German Council of Economic Experts advocates raising the risk-weighted capital for systemically important financial institutions to 20 percent (cf. GCEE Annual Report, Items 20 and 288). At present, the minimum capital adequacy ratio for banks is 8 percent. Internationally, discussions are taking place to raise capital requirements to 16 percent (cf. Box 11). Another question under examination is whether bonds should be included in the capital adequacy ratio, and then – instead of being redeemed – be converted to equity (convertible bonds) if the issuing institution faces the threat of insolvency. The Federal Government is open to participating in these discussions.

88. To tackle the current crisis, systemically important banks are to increase their capital adequacy ratios to 9 percent by 30 June 2012. The additional capital should convince markets that banks are also capable of bearing unforeseen losses from government bonds without endangering assets entrusted to them. This measure is designed to shore up confidence in the banking sector.

89. To enable the temporary increase in the capital adequacy ratio to be applied to systemically important banks as part of the coordinated procedure at EU level, the Federal Government has approved the draft second Financial Market Stabilisation Act (FMStG). This will allow the Federal Financial Supervisory Authority (BaFin) to impose higher requirements for capital adequacy ratios on certain institutions, and thus avert threats to the proper functioning of the financial market if necessary.

90. The higher requirements are largely to be covered on the capital market by banks and their owners. If a bank is unable to find sufficient funds in the market to cover its capital requirements, the Special Fund for the Stabilisation of Financial Markets (SoFFin), which expired at the end of 2010, will be reopened. According to the government's draft act, the SoFFin fund, to be revived by the end of 2012, can grant refinancing guarantees of up to 400 billion euro and direct capital aid of up to 80 billion euro, in cases of need and on application.

91. In the event of a bank becoming financially distressed, Germany has had legal mechanisms in place since 2011 for restructuring and for an orderly resolution if necessary. This particular set of instruments was developed with systemically important banks in mind. The banking supervisory authority has the power to intervene in the bank's business management, hive off systematically important business fields and transfer these to a bridge bank. Business fields that are not of systemic importance can be wound up. This approach ensures that private creditors can also participate in losses. In the long term, such restructuring would be financed by a bank levy fund. The European Commission intends to submit legislative proposals for EU-wide regulations in early 2012: these regulations would enable orderly cross-border resolution of systemically important banks. Both the Federal Government and the German Council of Economic Experts support this plan. According to the latter, national restructuring regimes "will prove of little use" unless they can be applied effectively to institutions operating across borders (cf. GCEE Annual Report, Items 21 and 260 – 266). With this in mind, the Federal Government favours the introduction of com-

parable resolution instruments in Europe. The Federal Government has some reservations about setting up a European Resolution Authority, as proposed by the German Council of Economic Experts (cf. GCEE Annual Report, Item 263), since financial oversight of banks in the respective countries is the responsibility of member states. However, it acknowledges that this supervision must be coordinated at European level.

Stiffer regulation of shadow banks and certain financial products

92. Shadow banks are specialised financial institutions and special funds that offer services similar to banks but are not subject to the regulation typically applied to banks. They include hedge funds and other alternative investment funds. In future, the managers of these shadow banks will need to meet requirements for capital adequacy and transparency of their funds, while also providing evidence of their credentials. The Federal Government will implement an EU directive to address this area before July 2013.

93. Shadow banks are not the only institutions that need to contribute to greater transparency in the financial markets. Derivatives traders, for example, will increasingly have to trade their products – including OTC derivatives – via regulated and transparent business exchanges. Their trades are to be recorded centrally in registers of transactions, as outlined in a draft regulation (cf. Box 11).

94. Some financial products carry high risks that threaten the stability of the finance system as a whole. These include commercial transactions involving stocks and government bonds, whereby market participants purchase these without actually owning them ("naked short-selling") and also credit default swaps (CDS) on government bonds that are not used for hedging purposes. Germany has applied transparency rules and strict bans in this area since 2010. Transparency rules for short-selling and bans on naked short-selling of certain stocks and CDS are now also to be introduced at EU level. The Federal Government welcomes and supports this initiative.

Instilling more confidence in investors

95. Since last year, consumers seeking investment advice on securities are entitled to receive clear product information leaflets that provide unambiguous statements on returns, risks and costs. In future, independent investment product brokers will be obliged to provide evidence of their credentials, take out professional indemnity insurance and have their details recorded in a public register of brokers. They will also be required to inform their customers of their broker commission. In addition, they must provide customers with a record of the consultation and a product information leaflet for the recommended investment product.

96. Discussions are underway at European level concerning measures to reform statutory audits. The measures should ensure greater competition in auditing large businesses, for example. The Federal Government is especially committed to further improving the calibre and validity of statutory audits.

C. Pro-growth fiscal policy

Germany leads the way in fiscal policy in Europe

97. Particularly in light of the debt problems in the eurozone, the central task of fiscal policy is to safeguard the confidence of consumers, businesses and the markets in public finances which are viable over the long term. This is a key precondition for continuous and sustainable economic growth. For this reason, Germany will rigorously comply with the consolidation obligations it has assumed at the national and international level, which include the requirements of the European Stability and Growth Pact and the Euro Plus Pact, as well as the debt rule enshrined in the German Constitution.

98. Economic and fiscal policy developments in Germany clearly demonstrate that a credible consolidation policy strengthens the foundations for domestic growth and enables the swift return to sound public finances. At 1.0 percent, the public-sector deficit rate last year was once again well below the 3 percent deficit ceiling stipulated in the Maastricht Treaty. This means that Germany has managed to meet the requirements of the European Stability and Growth Pact two years ahead of the deadline set by the European Union in the 2009 excessive deficit procedure in the wake of the economic and financial crisis (cf. Figure 9). Further to this, Germany is also committed to achieving a medium-term structural budgetary position of close to balance. Therefore, the

Federal Government will continue resolutely with consolidation measures despite additional burdens on the budget. We will place a continued priority on strict expenditure discipline, thereby making a substantial contribution toward permanently reducing the public spending ratio.

99. The positive effects of good economic performance and the adoption of measures contained in the consolidation package were already apparent in the 2011 federal budget. Furthermore, in the 2012 federal budget and the financial plan to 2015 the Federal Government falls well below the maximum net borrowing level which is admissible each year, thereby adhering to the structural deficit reduction path mapped out by the debt rule. Despite these positive trends, we must not lose sight of the fact that the federal budget requires further consolidation. The GCEE is critical of the government's austerity efforts, arguing that they had already begun to slacken last year (cf. GCEE Annual Report, Items 298 ff.) and demands even greater consolidation on the expenditure side. Furthermore, the economic climate, interest rate uncertainty and additional measures to tackle the debt crisis in some European states also hold considerable budgetary risks. Thorough compliance with the consolidation strategy defined in the current financial plan is therefore essential.

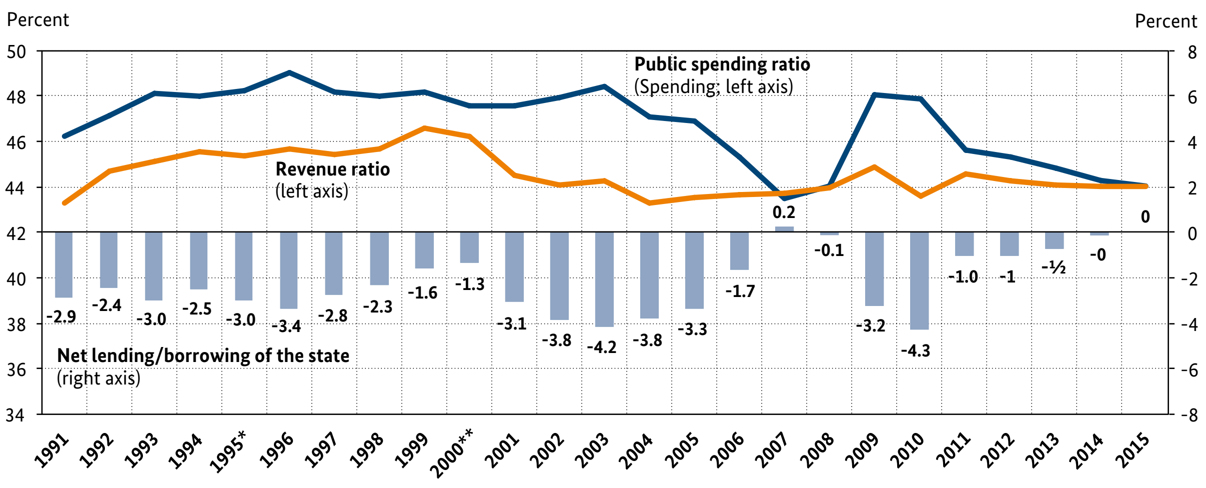
Pursuing growth-friendly consolidation

100. As early as 2009, Germany committed to rigorous budget consolidation by enshrining a new debt rule in the German Constitution. According to the GCEE, this debt brake has "become an exemplary regulation at the international level" in the course of the European debt crisis (GCEE Annual Report, Item 304).

Under the provisions of the debt rule, the Federal Government must gradually pare down its structural deficit to a maximum of 0.35 percent of GDP by 2016, and remain below this limit thereafter. From 2020 onwards, the *Länder* may not incur any new structural debt whatsoever. This approach reduces the German debt ratio – in other words, the proportion of Germany's debt relative to its gross domestic product – in a sustainable manner. This is also in line with the tighter rules of the European Stability and Growth Pact.

The GCEE believes that there is too much leeway in the application of the debt rule in some areas and calls for further clarification (cf. GCEE Annual Report, Items 305 ff.). For the Federal Government, the main purpose of applying the debt rule must always be the sustainable consolidation of budgets, which is assigned top priority.

Figure 9: Expenditure, income and net lending/borrowing of the state



* Excluding capital transfers resulting from the absorption of the debt of the *Treuhand* trust agencies and the housing associations of the GDR. Including this effect, the general government deficit was 9.5 percent of GDP.

** Excluding UMTS revenues. Including this effect, the state budget had a surplus of 1.1 percent of GDP.

Sources: Federal Statistical Office and Federal Ministry of Finance

101. Aiming to give greater consideration to the debt rule and better serve the goal of sustainable public finances, the government followed a top-down approach for the first time ever last year when preparing the 2012 federal budget and the financial plan to 2015.

In the process, the Federal Government defined key budget figures in March 2011 which set universal revenue and expenditure ceilings for the individual government ministries and individual budgetary positions contained in the federal budget and financial plan. These key figures were based on the government's macroeconomic forecasts. The top-down approach will also be applied in the years ahead.

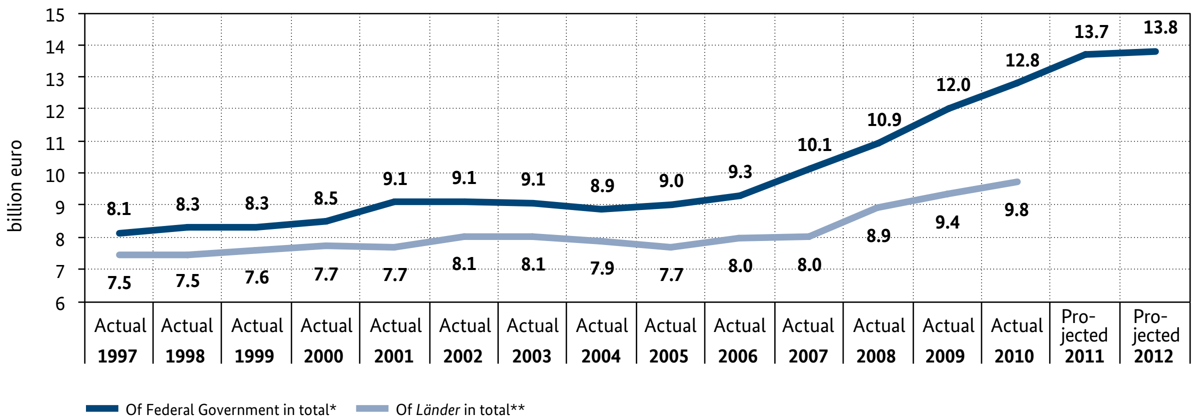
102. The top-down approach enables budget and financial plans to be clearly aligned with key policy areas and growth-friendly priorities from an early stage. The Federal Government had already introduced a policy of structural consolidation that increases Germany's medium- and long-term scope for growth with its 2010 consolidation package. Prioritizing expenditure on education and research also supports this policy. By allocating an additional 12 billion euro to these areas in the current period of legislation, the Federal Government is charting the course for the future viability of Germany as a centre for research and education. Furthermore, we have also set aside an additional 1 billion euro for investment in the German transport infrastructure (cf. Item 135), thereby boosting the share of investment spending in the federal budget over the long term (cf. Figure 10).

Relieving the burden on individuals and businesses to achieve greater equality and growth

103. Apart from budget consolidation, a growth-friendly fiscal policy involves allowing individuals to retain more of their earnings and giving businesses sufficient latitude to invest in the future.

Given the progressive structure of the income tax system, the state benefits from extra tax revenue generated by the effect of fiscal drag. The GCEE also believes that the fiscal drag presents a problem that must be addressed (cf. GCEE Annual Report, Item 349). The income tax rate will be corrected to offset this undesired tax burden, a measure that is fully aligned with the continued rigorous implementation of the debt brake mechanism. The extra tax revenue forecast for the coming years by the working party on *Tax Revenue Forecasting* in November 2011 gives the government the financial leeway for a schedule adjustment worth a total of 6 billion euro a year. On 7 December 2011, the Federal Government therefore adopted a draft act to reduce additional tax burdens deriving from fiscal drag which will be implemented in two stages, effective from 1 January 2013 and 1 January 2014 respectively. The tax relief will not be financed

Figure 10: Federal and *Länder* government spending on research and development



* Preliminary government spending in 2012 (government bill); 2009–2011 including the Investment and Redemption Fund without *Länder* allocation (second stimulus package); 2011–2012 including the Energy and Climate Fund (including electric mobility from 2012)
** Estimated 2010 *Länder* spending

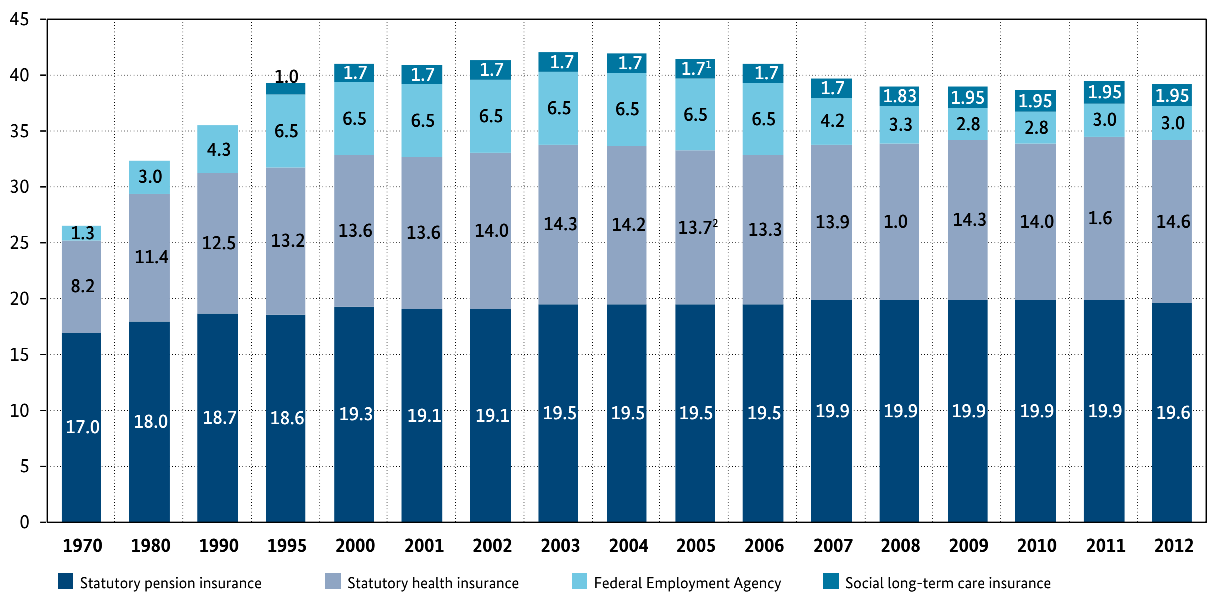
Source: Federal Statistical Office and Federal Ministry of Education and Research through new debt. Rather, the measures offset the effect of the state receiving extra revenue from taxpayers as a result of fiscal drag. The aim is to prevent a higher average tax rate being imposed on workers who receive a pay increase that simply keeps pace with inflation (cost-of-living raises). This ensures that the state does not benefit from pay increases that do not improve the economic position of the taxpayer. This is linked to the clear commitment to grow out of the debt burden and to consciously avoid any reliance on fiscal-drag-based revenue growth deriving from inflation-offsetting wage rises. This sends a strong signal for the rigorous implementation of a pro-stability policy and a fairer taxation system.

Starting in the 18th period of legislation, the government will assess the effects of fiscal drag in the tax schedule every two years. The German Council of Economic Experts is also in favour of the regular correction of the effects of fiscal drag at short intervals (cf. GCEE Annual Report, Item 344).

104. General taxation conditions can be a key factor when a business decides to invest. For this reason, the Federal Government is examining additional ways to make corporate tax law more modern and competitive at the international level, with particular attention given to the tax rules on the offsetting of profits and losses and the taxation of affiliated companies. The proposals of a special-purpose Federal/*Länder* working group will be considered by a joint Franco-German project which aims to explore ways of harmonising the corporation tax assessment basis in the two countries. In this context, Germany and France see themselves as the motor of European development.

105. Positive developments in employment and income have also lead to an appreciable increase in revenue from social security contributions. As a result, the Federal Government was able to lower the contribution rate for statutory pension insurance by 0.3 percentage points on 1 January 2012, delivering 1.3 billion euro in tax relief annually to both employers and employees from 2012 onwards. The rate of social security contributions that are co-financed by employers and employees is falling and remains steadily below 40 percent of wages. It will continue to stay below this level even after the slight increase in the contribution rate for social long-term care insurance scheduled for 2013 (cf. Item 132 and Figure 11).

Figure 11: Annual median social security contribution rates as a percentage of gross assessable earnings



[1] Excluding the additional contribution of rate 0.25 percent paid by childless individuals since 1 January 2005
[2] Average annual contribution rate without considering the member-specific contribution of 0.9 percent (this specific contribution was conceived as an additional contribution rate from 1 July 2005 to 31 December 2008)

Source: Federal Ministry of Labour and Social Affairs; status: 1 December 2011

Improving the financial strength of municipal governments

106. The commission for the restructuring of municipal finances concluded its work in June 2011 with a positive outcome for the municipal authorities. By raising the cost reimbursement rate, the Federal Government is appreciably easing the burden on municipal authorities as regards their net spending on basic social security benefits for the elderly and for individuals with reduced earning capacity. This measure delivers relief to the providers of social welfare benefits – and therefore municipal authorities in particular – which is expected to be worth more than 12 billion euro in the 2012 – 2015 period alone. This relief will specifically benefit municipal authorities that face pressing financial issues.

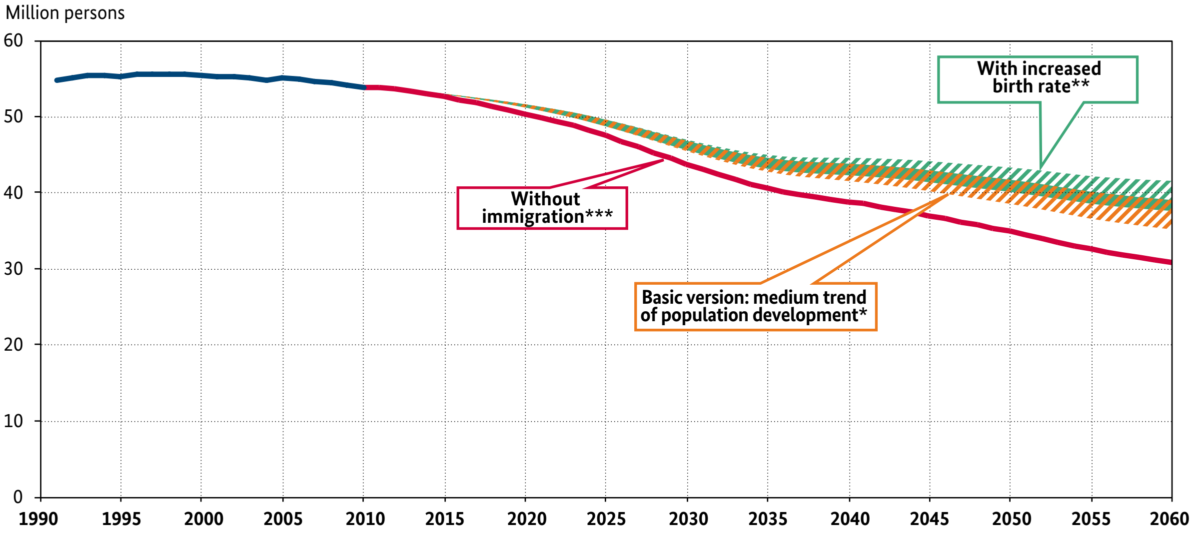
D. Work and education as drivers of growth

107. Germany's innovative capacity and prosperity are contingent upon the supply of skilled labour, by which we mean not only highly qualified professionals but every employed person. The effects of a shrinking and ageing population are being increasingly felt. In the past decade the working-age population has decreased significantly, a trend which is expected to continue in the years ahead (cf. Figure 12).

108. Aside from the effect of demographics, the strong demand for skilled workers also reflects the current success of the German labour market: unemployment is at its lowest level since 1991 and the German jobless rate is one of the lowest in Europe. Long-term unemployment has also decreased significantly, down more than 40 percent since 2005. At the same time, the number of vacant positions remains high. There has been a marked increase in the rate of employment in jobs requiring social security contributions, growing at a faster pace than the rate of employment overall. Jobs were created in practically every industry.

109. Policymakers, the business community and trade unions must make every effort to broaden the skilled workforce base in Germany. More individuals who are currently unemployed must be reintegrated into employment. Furthermore, more and better qualified people must be available to the labour market or must

Figure 12: Population of working age (aged 15 to 64 inclusive)



* Version 1 "medium population trend": birth rate virtually constant at 1.4 children per woman; life expectancy (in years) of newborns in 2060: boys 85.0; girls 89.2 annual net migration in persons: 100,000 from 2014, 200,000 from 2020.
** As version 1 but with increase in birth rate to 1.6 from 2025.
*** As version 1 but net migration at 0.

Source: Federal Statistical Office, 12th Coordinated Population Projection be able to stay in the workforce for longer. This requires the right framework to ensure, in particular, that more women, older persons, the low-skilled and individuals with an immigrant background can, and want to, take up employment. In addition, Germany must become a more attractive destination for highly skilled third-country nationals.

Managing the demographic change

110. The Federal Government will strategically address the challenges posed by demographic change in order to safeguard long-term prosperity and growth (cf. Box 7). In October 2011, the government submitted a *Report on the Demographic Situation and the Future Development of the Country*. The demography report presents important facts about the demographic change, describes the primary measures of the Federal Government and identifies key areas for future action. Furthermore, the importance of education, science and innovation in a society that lives longer is underlined in the *Research Agenda for Demographic Change: Age has a Future.*

111. The Federal Government wants to seize the opportunities presented by demographic change and take a proactive approach to tackling the challenges posed. For this reason, we will put forward a demography strategy in spring 2012, which builds on both the demography report and the concept for action presented for the eastern German *Länder*, entitled *Sustainable Services of General Interest in Light of Demographic Change.* The demography strategy will illustrate the strategic approach of the Federal Government on the basis on the following four headline goals:

Box 7: Demographic change in Germany

In the decades ahead, the demographic change will increasingly shape economic and social developments in Germany. Taking a strategic approach to face this change, and seizing the opportunities it presents, will be one of the biggest challenges for the social market economy and prosperity in Germany.

The demographic change is primarily determined by the number of births and deaths and the ratio between inward and outward migration, and is characterised by five specific trends:

1. The level of fertility in Germany is persistently low and, for roughly 40 years, has been one third below the replacement level (the level needed to maintain population numbers). At around 1.4 children per woman, Germany's birth rate is far below the OECD average of over 1.7. The share of older people in the population is increasing since the generation of children is smaller than the generation of parents.

2. Life expectancy is constantly increasing, tipping the balance of the population make-up further towards older citizens.

3. Inward and outward migration have a marked effect on population trends. In the past, Germany was a country with very positive net immigration, which helped to soften the ageing process. With a decreasing and sometimes even negative migration balance experienced for many years, Germany reported positive net migration once again in 2010. The lifting of restrictions on 1 May 2011 on the free movement of workers from countries that joined the EU in 2004 also resulted in a moderate increase in immigration from nationals of these countries.

4. Demographic trends differ from region to region within Germany. Many areas of eastern Germany are facing a significant decline in the population and an ageing population base. Increasingly, however, the same can be said for many rural and urban regions in western Germany.

5. In recent decades there has been a greater ethnic mix in the German population.

- Identify and seize the opportunities of a longer life span
- Strengthen growth prospects and safeguard prosperity
- Maintain and strengthen social equality and cohesion
- Safeguard the state's scope for action

Skilled labour for a strong economy

112. The Federal Government took an important step in June 2011 with its *Skilled Workers Strategy (Konzept Fachkräftesicherung)*, whose guiding principle is to explore every avenue to close the skills gap in the country. It details goals and measures to secure skilled workers along five specific paths:

- Labour market mobilisation and safeguarding of jobs
- Combining family and career
- Education for all from the outset
- Skills development: initial and further training
- Integration and qualified immigration

113. To accompany its *Skilled Workers Strategy,* the Federal Government has introduced a series of measures aimed at helping SMEs or economic regions particularly affected by the skills gap to meet their local need for qualified workers. For example, the *Centre of Excellence for Securing Knowledge Workers* is specially geared towards small and medium-sized enterprises. As part of the *Skilled Workers for the Region* programme, support is given to regional networks and projects to secure the supply of skilled labour. The *Programme for the Future Supply of Skilled Labour* provides solutions specially tailored for eastern Germany where demographic change is particularly rapid (cf. 2011 Annual Economic Report, Item 106). Furthermore, the Federal Government is currently developing an instrument ("the job monitor") to better gauge current and future demand for labour by industry, region and specific skill sets.

The German labour market – the flexibility for success

114. Germany's upswing in employment reflects the responsible attitude of the partners to collective bargaining agreements and the healthy economic climate. It is also the product of the greater flexibility of the labour market (cf. Box 8). The German Council of Economic Experts also supports this opinion (cf. GCEE Annual Report, Item 461). The Federal Government will consistently safeguard and expand the flexibility and efficiency already achieved on the labour market to drive further employment and growth.

115. The Federal Government already reformed the instruments of active labour market policy last year, making them more effective and efficient. The Act to Improve the Chances of Integration in the Labour Market aims to make better use of the resources available and to expedite integration into gainful employment, particularly in jobs that require the payment of social security contributions. The Act strengthens the decision-making power of local agencies. The aim is to equip local job placement agents with flexible labour market instruments that can be tailored to suit the individual support scenarios. The government is also expanding and strengthening quality assurance surrounding the involvement of labour market service providers. The number of labour market instruments has been reduced by around one third and the scope of employment promotion measures has been increased.

The Temporary Employment Act has also been revised to reduce the risk of abuse of the temporary work system. As a result of the Act, permanent staff can no longer be laid off and then rehired in their former company as temporary staff but with worse working conditions than the permanent staff. At the joint suggestion of the collective bargaining parties for temporary work, a salary floor was fixed for temporary staff once the necessary legal framework had been created for this in April 2011. The potential of temporary work is to be retained as an instrument of employment policy. This is also suggested by the German Council of Economic Experts (cf. GCEE Annual Report, Items 480 ff.).

116. For many people, the opportunity to earn a supplementary income opens a door into the general labour market. This is what prompted the Federal Government to further refine the rules governing exempt earnings for recipients of long-term unemployment benefit last year. Aiming to support and encourage such benefit recipients to take up jobs that require the full payment of social security contribu-

Box 8: Labour market reforms strengthen the functioning of the labour market

Successful labour market reforms have created a much more resilient and flexible German labour market. The reforms focused on restructuring the social systems with the aim of the swifter and more effective integration of jobseekers into the primary labour market. This was accomplished through the comprehensive mobilisation and efficient placement work of the employment agencies and job centres, and through the greater willingness of jobseekers to make concessions when taking up employment. In addition, the legal framework for temporary work, marginal employment, short-time work arrangements, part-time and fixed-term employment has been further enhanced in recent years. These flexible forms of employment can accommodate the many interests and requirements of the market participants, adding diversity to the labour market. At the same time, employment subject to social security payments has risen further.

The reforms were continued consistently in the past two years. The job centre reform created the organisational conditions for collaboration between the municipal authorities and the Federal Employment Agency to enable the job centres to efficiently place individuals in jobs that fit their profile. Furthermore, with the adoption of the *Act to Determine Social Benefits Rates* the Federal Government has rendered the calculation of standard benefit rates in basic social security transparent and has redefined the amounts of exempt earnings for recipients of long-term unemployment benefit, a measure which has made people more willing to work in a job that requires the payment of social security contributions.

Along with the responsible attitude of parties to collective bargaining agreements and changes businesses have made to their in-house working hour arrangements, these reforms have made a key contribution to Germany's employment upturn. Two particular developments emphatically demonstrate the structural improvements on the German labour market:

- Over several economic cycles, labour market developments in Germany were characterised by *hysteresis*: long-term unemployment intensified, unemployment rose considerably with each downturn and could not be reduced in the following upswing, and ended up stagnating at a higher level. For the first time in decades it has been possible to break this cycle. Unemployment only increased moderately in the last economic crisis despite a drastic decline in exports and production. With the latest economic rebound, the number of jobless has dropped below the pre-crisis level. The number of long-term unemployed also fell at an even faster rate than the number of jobless overall (cf. Figure 2).

- At the same time, labour market equilibrium has improved, as illustrated by the Beveridge curve (cf. Figure 13). The *Beveridge curve* represents the relationship between unemployment and job vacancies. A large number of unfilled jobs with a simultaneously high rate of unemployment is an indicator of an inefficient labour market, known *as mismatch*: jobseekers' skills do not fit the vacant positions, and market equilibrium only works to a limited extent. During the boom year of 2001, 3.9 million people were unemployed even though the number of vacancies was high. Ten years later, the situation has changed. While the number of unfilled jobs had shot up once again in 2011, around one million fewer people were unemployed than in 2001. The labour market reforms improved the functioning of the labour market and rectified the mismatch. Represented in graph form, the Beveridge curve has shifted inward.

tions, the measure also hopes to discourage excessive recourse to very low-paying jobs and other employment relationships that intend to cover up illegal work. The impact on the labour market of the current exemptions is currently being monitored so that any necessary action can be taken this year.

The Federal Government is also examining the increase in and dynamisation of the threshold for mini-jobs not subject to social security contributions. This is currently still ongoing.

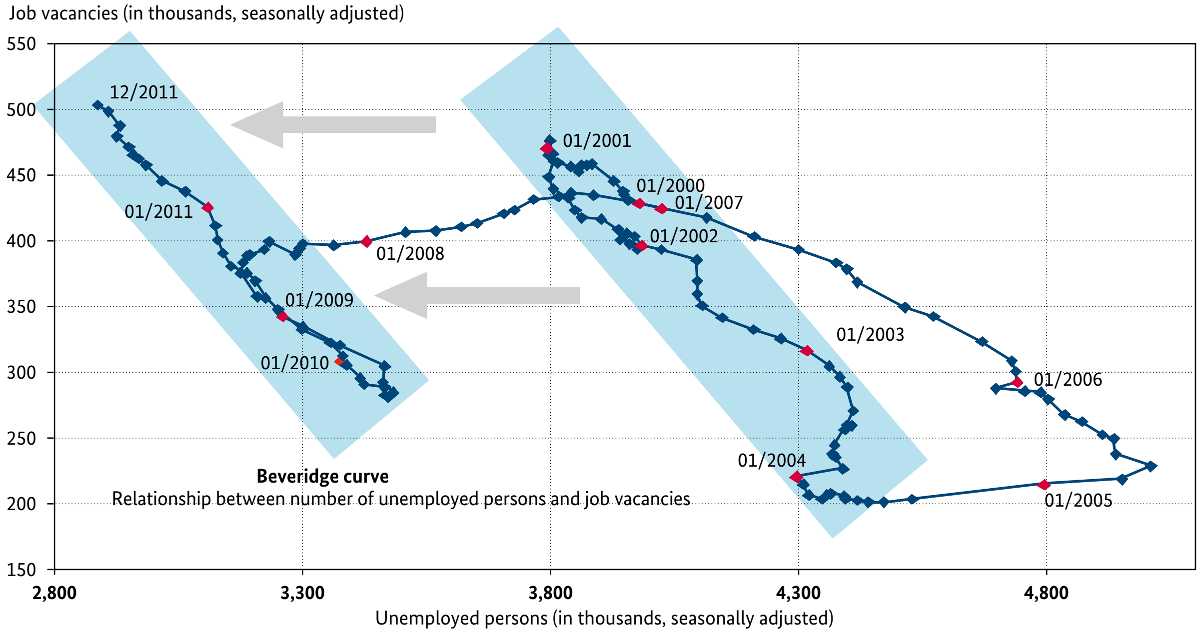
117. In January 2010, the European Court of Justice issued a ruling stipulating that periods of employment before an employee reaches the age of 25 must be included when calculating the periods of notice for termination. The current regulation in the German Civil Code, which is contrary to this ruling, may therefore no longer be applied. The Federal Government will examine the action that needs to be taken as a result of the ruling.

118. With the significant involvement of the specific social partners, the Federal Government reached a decision concerning sector-specific minimum wages under the framework of the Posted Workers Act and the Temporary Employment Act in the reporting period. The majority of the GCEE members are opposed to statutory minimum wages (cf. GCEE Annual Report, Item 467). The current sector-specific minimum wages have been evaluated on behalf of the Federal Government. The appraisals are an important step towards an objective, facts-based debate on the implications of current minimum wages for specific industry sectors. They suggest that a minimum wage has a very different effect on different areas, such as employment, competition and worker protection.

A policy of open immigration for skilled workers

119. The Federal Government has already launched a number of measures to make Germany more attractive to foreign professionals, including steps taken as part of its *Skilled Workers Strategy*. Highly skilled immigrants strengthen the knowledge base, lift growth potential in Germany and help the country to better shoulder the growing burdens associated with an ageing and shrinking population. By amending immigration law, the Federal Government is therefore making Germany a significantly more attractive destination for highly skilled workers. Bureaucratic obstacles are being

Figure 13: Efficiency on the German labour market



Source: Federal Employment Agency; own calculations removed and the decisions surrounding the right of residence for skilled workers are being more clearly aligned with transparent, systematic and unambiguous criteria.

120. To this end, the Federal Government tabled a bill at the start of December 2011 which proposes to reduce the salary threshold above which highly skilled foreign workers are permitted to establish themselves in Germany without bureaucracy and without delay from 66,000 to 48,000 euro. As a result, far more people can make use of this mechanism to enter the German labour market than before.

The Federal Government is taking advantage of the flexibility afforded by the EU Directive on the Conditions of Entry and Residence of Third-Country Nationals for the Purposes of Highly Qualified Employment to create attractive conditions for the *EU Blue Card* system. Under the new rules, anyone offered a job in Germany with a salary of or above 44,000 euro will be able to take up this employment immediately. In certain occupations where there is a skills shortage, particularly in the fields of mathematics, informatics, natural sciences and technology, and in the case of IT specialists and doctors, the salary threshold is 33,000 euro. In such instances, however, authorities will check whether the working conditions for the foreign employee are less favourable than for a German employee in a comparable position. Under the provisions of the *EU Blue Card* system, non-nationals will be entitled to a permanent settlement permit after two years of work subject to insurance contribution payments. Furthermore, the Federal Government will step up its efforts abroad to recruit talented professionals for the German labour market.

Third-country graduates of German institutions of higher education are granted a residence permit without further vetting by the Federal Employment Agency if they secure suitable employment. Further to this, in the job-seeking year foreign graduates can also take up any employment to secure their livelihood. In the future, non-nationals who have completed vocational training in Germany will be given the opportunity to take up employment in their field in Germany on completion of training. The Federal Employment Agency will grant approval without checking whether priority candidates (e.g. Germans and EU citizens) are available for the position. With the Act to Improve the Assessment and Recognition of Professional Qualifications Acquired Abroad, the Federal Government has created the framework for the systematic acceptance of foreign vocational credentials. With regard to vocational training, the *BQ-Portal* information platform will provide chambers and businesses with information on professional qualifications in different countries to aid the appraisal of foreign qualifications. All these measures help boost the supply of skilled labour and improve the integration of migrants living in Germany.

121. Restrictions on the free movement of workers within the EU-8 countries were lifted in May 2011. Since then, citizens of the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia have been free to work in Germany. Employment of individuals from these countries has only risen marginally, however, which has done little to ease the shortage of skilled workers. Fears that the free movement of workers would cause social upheaval on the labour market have proven to be unfounded. Furthermore, starting this year graduates, skilled professionals, applicants for apprenticeship places and seasonal workers from Bulgaria and Romania have to face far less bureaucracy when entering the German labour market.

Education first

122. Good education at every age increases our personal opportunities in life and advancement prospects, and is the key to growth, employment and innovation. As part of the *Skills Development Initiative for Germany*, the Federal Government has created a package of measures in all areas of the education system. At the same time, the government and the *Länder* have agreed to increase national spending on research and education in Germany to 10 percent of GDP by 2015.

123. Early childhood education is the cornerstone of opportunities for development and advancement and also helps parents better combine career and family commitments. For this reason, the Federal Government is committed to asserting the legal right of parents to needs-oriented child care for children over the age of one starting in 2013. To support parents' right to free choice, plans are also afoot to introduce a child care allowance. The Federal Government is investing 4 billion euro in expanding the child care infrastructure

and improving the quality of care services for the under-threes, and also lends support to the *Länder* to cover the costs of running child care and day care facilities. According to the second evaluation of programme implementation in May 2011, it will be possible to meet the goal of making 750,000 child care spaces available by 2013 if the *Länder* also deliver on their obligations to expand child care provision and support the municipal authorities in their efforts.

124. In a given school year, almost two-thirds of pupils decide to pursue vocational training. The opportunities this route also affords to high-achieving young people are the focus of the *Berufliche Bildung – praktisch unschlagbar* (vocational training – practically unbeatable) information campaign launched by the Federal Government and the business community as part of the *Training Pact.* Talented workers seeking to advance their career can avail of the opportunities presented by the *Upgrading Training Assistance Act (Meister-BAföG),* the *further training and advancement grants* and *the Advancement through Education: Open Universities* programme, a competition which supports institutes of higher education with study programmes geared towards people with family commitments who are returning to the workforce, working persons or individuals re-entering the labour market.

125. The *Abschluss und Anschluss – Bildungsketten bis zum Ausbildungsabschluss* education initiative aims to support young people in entering a career and prevent long waits in the transition system. The *National Strategy for Adult Literacy and Basic Education* gives adults a second chance to improve their skills level, and the refined special *WeGebAU* programme, which focuses on continued in-company training of low-skilled and older workers, encourages skills development among employees without a vocational qualification or low-skilled workers in small and medium-sized enterprises. The *Initiative to Support Structural Change* (IFLAS) enables low-skilled individuals to obtain a vocational qualification or learn particular skills if it is not possible for them to complete a vocational training programme in one go. Furthermore, through various outreach programmes the Federal Government aims to assist young people who are no longer served by the current range of educational services in schools and training programmes, and boost their integration into the working environment.

126. Despite the need to pursue a policy of budget consolidation, the Federal Government will continue the successful *Higher Education Pact 2020* in tandem with the *Länder*. A demand-driven portfolio of study programmes is available to the growing number of prospective students. This is also in light of the double number of school-leavers due to the reduction in the number of school years until the *Abitur* examination is taken from 13 to 12 and the abolition of compulsory military and alternative civilian service. The Federal Government has also taken this latter development into consideration with the creation of the new federal volunteer service and the improvement of existing youth volunteer services. The scope of the pact has also been extended with the implementation of the *Quality of Teaching Pact* aimed at better study conditions.

The number of students receiving federally funded grants has more than doubled since 2005. Since the 2011 summer semester, high-achieving students have also been supported through the new *Deutschlandstipendium* programme, a grant programme equally co-funded by the Federal Government and the private sector. In 2012, 1 percent of students should receive grants under the *Deutschlandstipendium* programme.

A long-life society – capitalising on experience

127. Given Germany's ageing population, employers must adapt to a maturing workforce. Such workers have valuable skills and expertise. Supporting this viewpoint, the German Council of Economic Experts (cf. Spring Report, Items 156 ff.) goes even further and proposes linking the statutory retirement age to increasing life expectancy in order to guarantee the long-term stability of the pension system (cf. GCEE Annual Report, Item 514). The Federal Government is committed to lifting the retirement age to 67, a measure which is also a matter of economic and social necessity in light of the shortage of skilled labour. The Federal Government is exploring options to create a more flexible framework for a longer working life.

128. Above all, the onus is now on businesses to foster the employability and working capacity of their staff over their entire working life, and strengthen the employment of mature workers. In particular this means appropriate working environments for older workers, forward-looking work structures and work organisation, tailored fur-

ther training and in-company health promotion programmes. The Federal Government lends support by implementing projects to improve guidance for in-company integration management *(IIM)* for small and medium-sized businesses in line with the requirements of Social Code IX. The aim of IIM is to improve the reintegration of the long-term sick into the working environment and ensure such workers can remain in gainful employment as long as possible.

Further to this, the Federal Government will map out a preventative health strategy. In this connection, in-company health promotion programs are also to be developed further. While large firms have successfully implemented such programs up to now, the Federal Government will place a higher priority on also encouraging small and medium-sized enterprises to make proactive in-company health promotion programmes part of their agenda in the future.

129. The growing number of older individuals in our society presents an enormous challenge for health and care services. For this reason, the Care Structures Act has created the framework to ensure all insured persons in Germany can enjoy general needs-oriented healthcare delivery in their local area.

130. The Federal Government will also continue to develop the long-term care insurance system. The overall goal of reforming long-term care insurance is to deliver services that are more deeply aligned with patients' needs, particularly those suffering from dementia. The work on a new definition of persons in need of long-term care will be completed during this period of legislation. Furthermore, the principle of *"out-patient before in-patient care"* will be strengthened further, and family carers and families are to receive more support.

With the adoption of the Family Care Leave Act, the Federal Government has already significantly improved conditions for individuals wishing to combine their career with the care of a family member.

The Federal Government will present a separate catalogue of measures to reduce bureaucracy in the care sector.

Seeking to fill the skills gap in the care sector, the Federal Government intends to make this field more appealing to potential workers. Vocational training programmes for nursing, elder care and paediatric care will be regulated by one occupational law. The Federal Government has launched an *Elder Care Training and Skills Development Initiative*, which is co-funded by the Federal Government, the *Länder* and industry associations. By establishing concrete agreements, the aim is to strengthen initial and further training in this field and make employment conditions more attractive.

131. The system of funding long-term care insurance will be put on a more sustainable footing, particularly in the face of changing demographics. The contribution rate for long-term care insurance will increase by 0.1 percentage points starting on 1 January 2013. This makes an additional 1.1 billion euro available for social long-term care insurance every year, which will be able to completely fund the planned improvements in benefits. The benefits of social long-term care insurance will continue to be financed solely through contributions. Reserve funds will not be tapped.

132. Alongside this, private pension arrangements are a central component of future personal security plans. More support will be given to such arrangements in the future, as individuals with voluntary private pensions for long-term care benefits will enjoy tax advantages starting on 1 January 2013 in addition to the current system of capital-based pension provision.

E. Sustainable growth through competition

133. Competition thrives in an environment with a very few, clearly defined, transparent rules. The social market economy requires a regulatory framework for sustainable economic activity. State regulations safeguard fair systems, equal opportunities and environmental compatibility and provide incentives for innovation. Important steps towards creating more competition drive the agenda particularly in the transport sector. The aim here is to bring about a further improvement in the transport infrastructure. Regions, too, are also engaged in productive competition with one another.

Strengthening competition on a broad front

134. With the eight amendment to the Act against Restraints on Competition (ARC), the Federal Government plans to modernise the general competitive framework in Germany. The amendment aims to further improve the rules governing competition, particularly in the areas of merger control and monitoring to prevent abuses of market dominance. The overriding goal of the amendment is to reduce the disparities between German and European merger control to enable planned mergers to be assessed concurrently. Under the provisions of the amendment, Germany's stricter regulations to prevent abuses of market dominance remain in place so that small and medium-sized enterprises can continue to enjoy effective protection against abusive conduct. At the same time, however, the regulations are to be simplified and made more understandable and user-friendly. The text of the ARC will now also include the possibility of unbundling companies in the event of abuses of market dominance, which already exists at the European level and also applies to German businesses. The role of consumer associations will also be strengthened to support the private enforcement of anti-trust law. Finally, the amendment is designed to boost the efficiency of anti-trust penalty proceedings. (The need to amend the 4th part of the ARC and related secondary regulations is based on EU law surrounding public procurement.)

135. The Federal Government wants to increase competition in the rail market in Germany and Europe, and is revising regulatory provisions for the railway sector to this end. In particular, the fees which railway undertakings are obliged to pay for using the railway tracks and stations will be completely overhauled. This aims at the more efficient provision of the railway infrastructure and improved market access for new competitors, for example. The Federal Network Agency (BNetzA) will also be granted more authority. Related proposals are currently also under debate at the European level *(Recast First Railway Package)*. In discussions at the European level, the government is committed to achieving a better regulatory framework and more open rail markets across Europe.

In the regional rail passenger sector, the Federal Government expects the *Länder* and the railway undertakings to make more extensive use of the opportunities and possibilities of competitive procurement procedures on the basis of the Act against Restraints on Competition, as defined in the ruling of the Federal Court of Justice in February 2011. The government will keep a close eye on further developments in this market and support progress in competition.

With the Act to Amend Passenger Transport Regulations, the Federal Government is also increasing competition in the transport sector. To secure private-sector involvement in public short-distance passenger transport, the principle of primacy of commercially managed transport services will be retained. In the case of publicly funded transport services, competitive procurement procedures should ensure the best transport service. Furthermore, the government plans to largely liberalise the long-distance coach transport system to strengthen competition and improve the range of transport services available to consumers.

136. The Federal Government is strengthening competition and consumer protection in the telecommunications sector with the amendment to the Telecommunications Act. At the same time, the government is also improving conditions for broadband expansion and investment in new networks that is in line with competition law (cf. Item 156). In this way, the Federal Network Agency can increase businesses' planning certainty in the future by publicising regulatory principles and providing information on the regulatory framework for next-generation networks. Access to alternative infrastructures and ducts will be easier and companies can share existing infrastructures for broadband purposes. In turn, the Federal Network Agency is entitled to

obtain information on suitable infrastructures from the companies and disclose this information to stakeholders.

The Federal Government plans to examine the competitive framework in the postal sector.

137. In its country-specific recommendations, the EU affirms that Germany has made much progress in recent years in increasing competition in the services sector. In this connection, the Federal Government will examine whether there is further scope for relaxing existing restrictions on entering and practising a profession without compromising on quality or safety. Prices and fees must be more closely aligned with supply and demand.

138. Self-determined, well-informed consumers drive competition. Competition for goods and services offered on the internet can only unleash its potential if consumers are adequately protected from Internet fraudsters, a measure which will also strengthen the position of honest traders. Up to now, untrustworthy businesses have intentionally used unclear or misleading websites to trick unwitting consumers into believing their services are free. The Federal Government has successfully worked at the European level to ensure that the Consumer Rights Directive will prevent cost traps in the future.

Investing in a modern and efficient transport infrastructure

139. A modern and efficient transport infrastructure is a vital precondition for ongoing growth. At the international level, Germany's transport infrastructure gives it an edge over other countries competing to attract business. Nevertheless, the federal transport network is beginning to show its age. This is why the state must continue to finance large investments in the transport infrastructure, but more so in infrastructure maintenance than infrastructure development, however. Despite the need for austerity measures, we have managed to stabilise the annual investments in rail, road and waterways at a level of around 10 billion euro in the medium-term financial plan. Further to this, the Federal Government has increased federal investment in the transport infrastructure by 500 million euro this year and by a total of another 500 million euro in the years up to 2016. This means that more annual funding is available on average than in the 2002 – 2008 fiscal years prior to the economic and financial crisis.

140. New and supplementary financial instruments will secure and strengthen the transport infrastructure. To this end, a road-financing scheme was incorporated into the 2011 federal budget to guarantee long-term funding for roads in the federal budget and to render funding more transparent. Tax-financed budget funds that were released as a result of the road-financing scheme were provided to the rail and waterway infrastructure.

Supporting regional competition for business

141. Competing regions should be mobilised, not artificially propped up. For this reason, the Federal Government pursues a regional policy that focuses on strengthening the adaptability, competitiveness and individual responsibility of businesses and workers in structurally weak regions.

142. The joint Federal-*Länder* programme *"Improving the Regional Economic Structure"* (German abbreviation: GRW) and the European structural policy are key tools of regional policy. This programme secures and creates permanent jobs based on the development opportunities available in the particular regions. The special GRW programme to support economic development was phased out at the end of 2011. Even though the GRW makes a significant contribution to fiscal consolidation from 2011 onward, a targeted high level of regional support is possible in 2012, with a total of 597 million euro of federal funding available. With regard to new projects, as before 6/7 of GRW funding will be allocated to eastern Germany and 1/7 to western Germany in subsequent years (commitment appropriations).

143. The European structural policy aims to reduce the disparities in the level of development between European regions and member states, and thereby foster economic, social and territorial cohesion in the EU. In the forthcoming programming period from 2014 to 2020, the EU structural funds will be central to attaining the goals of the Europe 2020 growth and jobs strategy, and thereby support smart, sustainable and inclusive growth. The member states, the European

Commission and the European Parliament will negotiate the content and financial framework of the future EU structural policy in the months ahead. Germany's key demands are as follows:

- All member states and regions will continue to receive support in the future
- Fair and appropriate transition guidelines (safety net) for the regions (including eastern Germany) that no longer fall into the maximum support category (goal of convergence)
- Flexible funding strategies aligned with regional needs
- Significantly simplified funding management
- Increased funding focus on maintaining and developing competitiveness
- Stricter conditions for member states that have problems with their competitiveness or with an excessive deficit
- Terms for funding beyond this are only acceptable under a narrow set of conditions

Given that the investment allowance provided in eastern Germany will be phased out in 2013 and a lower amount of funding is expected from the European Structural Fund in the funding period starting in 2014, the GRW will become increasingly important for the regions.

144. While the eastern German economy continues to catch up, there is still a significant gap between the key performance indicators of the new *Länder* and western German *Länder* despite positive developments. The Federal Government is tackling the remaining structural challenges in the eastern German *Länder* with its successful support strategy to strengthen the drivers of growth and the competitiveness of this part of Germany (cf. Items 112, 142 and 155). The continued high level of investment support and the promotion of research and innovation are the central pillars of this national support strategy, with cluster development and R&D networking being two examples of support areas. Continuing until 2019, the Solidarity Pact II provides a reliable financial framework for the further development of the eastern German *Länder*. To safeguard the progress made, the Federal Government will work to ensure that the eastern German *Länder* will continue to receive adequate support through the European Structural Fund even after 2013 in the framework of the transition guidelines.

Priority will be assigned to continuing and completing the German Unity Transport Projects that are still under construction. Furthermore, the Federal Government has called for the European Transport Policy to consider numerous motorway and rail links in the eastern German *Länder*, including the Rostock-Berlin-Dresden rail link, for example, as a north-south connection.

145. In structurally weak rural regions that particularly feel the brunt of demographic change, tourism development can provide the impetus for investment and modernisation projects. The Federal Government is therefore developing a set of best practice guidelines for rural areas. Furthermore, we are also fostering the modernisation of tourism structures with regard to accessibility and in the fields of waterborne and health-related tourism, for instance. Generally speaking, tourism in Germany continues to thrive, particularly in urban areas.

In favour of bureaucracy reduction and better regulation

146. Excessive bureaucracy stifles competition. With its *Bureaucracy Reduction and Better Regulation* programme, the Federal Government has created an effective instrument to reconcile regulatory requirements and the resulting monetary and time costs. In previous years, the programme focused on cutting the net cost of bureaucracy from reporting obligations (e.g. documentation requirements) by 25 percent by the end of 2011 compared with figures for 2006. In 2011, the Federal Government increased the scope to study the total measurable costs associated with compliance with requirements under federal law (substantive compliance costs). When a new regulation is now tabled, the associated costs of compliance for individual citizens, the business community and public administration will be calculated and presented, and is also vetted by the independent National Regulatory Control Council (NKR). This delivers transparency, gives lawmakers more infor-

mation on the implications of a new regulation and puts talks with affected stakeholders and advocacy groups on a broader footing. In addition, the substantive compliance costs have been calculated in various areas of legislation and scope for simplification identified. The Federal Government regularly announces the development of substantive compliance costs in its reports to the *German Bundestag*.

Overall, the time and monetary costs arising from necessary regulations should be kept to a minimum. It was possible to reduce the annual costs of bureaucracy which federal reporting obligations imposed on the business community by roughly 11 billion euro per year between 2006 and the end of 2011. With the *key elements to further reduce the costs of bureaucracy for the business sector* which were agreed last year, the Federal Government has initiated additional measures to cut red tape and ensure the 25 percent target is reached.

F. Progress through technology and innovation

147. Research and innovation are the drivers of economic growth and social change. In order to be able to develop fully, innovative companies need a favourable regulatory environment and new insights from the scientific community. The prerequisites for a transfer of research results to products and services are research-intensive companies and good knowledge and technology transfer. With its diverse activities in research and innovation funding, qualification, start-up support and standardisation the Federal Government has created what is by international standards an excellent climate for innovation.

Research and innovation are expected to contribute to overcoming the most important global social challenges of the future – such as climate change, demographic ageing, and security. At the same time the technological solutions achieved enable German companies to maintain their advantage against global competition.

Research for the technology of tomorrow

148. With its *High-Tech Strategy 2020* the Federal Government has developed an over-arching strategy designed to address the main social areas, i.e. climate and energy, health and food, communication, mobility, and security, as well as the key technologies required as a solution to these challenges. Building on this ten projects have so far been developed which focus on concrete areas of innovation of special importance. In each project, solutions are worked out by means of a targeted application of the strengths of industry, the scientific sector and government.

149. The scientific sector makes a critical contribution to progress through innovation. The Federal Government and Länder are therefore providing support for the institutes of higher education, among other things with the Excellence Initiative, which goes into its third round of funding in 2012 and for which the Federal Government alone has earmarked 300 million euro. In addition, in the second leg of the Higher Education Pact the Federal Government is making a further 300 million euro available to the universities for the programme allowances in the framework of the funding by the German Research Foundation (DFG). The allocations for the major non-university research institutions are being increased by 5 percent per annum up to 2015 under the *Research and Innovation Pact.*

150. Intensive co-operation between industry and the scientific sector can release additional innovative power. In 2011 a new cross-sectoral measure to improve co-operation between the scientific sector and industry was launched in the form of the *Research Campus* funding initiative.

151. With the creation of the *German research and innovation forums/centres* (DWIH) the Federal Government is making a contribution to improving Germany's international prominence as a research and technology location.

Incentives for innovative start-ups

152. Innovative start-ups create jobs geared to the needs of the future and transform ideas and scientific discoveries into marketable products. However, they involve particular risks, especially in the development of new technologies, as these first have to gain acceptance in the market. The aim of economic policy is to improve the regulatory framework and incentives for the creation of companies. The Federal Government is implement-

ing numerous measures to create additional stimuli for a sustained improvement in growth in start-ups.

The scientific sector's *EXIST-Existenzgründungen* start-up programme gives entrepreneurial students and scientists opportunities for developing an idea from the scientific environment into the basis for a marketable business concept. In order to help company founders in the IT sector gain entry to new and international markets, in September of last year the Federal Government started its *German Silicon Valley Accelerator* pilot project. The project facilitates access to the resources of Silicon Valley and creates contact with the owners of know-how and technology in the US.

153. The *High-Tech Start-Up fund* has proved its value in recent years as an engine for the financing of new technology companies and was therefore relaunched in October last year. This follow-on fund was reformulated as a public-private partnership with participation by industrial investors and the KfW banking group. The involvement of the Federal Government was sharply reduced and more than twice as many private investors were obtained as for the first fund.

Innovative small and medium-sized enterprises

154. Above all, innovative companies need an innovation-friendly regulatory environment. The Federal Government will revise the legal metrology system in order to adjust it to suit international and technical developments, such as in nanotechnology, and will further expand the excellent quality infrastructure. In addition, in the framework of the *Transfer of Research and Development Results through Standardisation* (TNS) funding programme it is supporting aspects of standardisation in commercial research projects.

Small and medium-sized companies (SMEs) are close to the market and so greatly contribute to growth through innovation. However, it is frequently precisely these companies which lack the necessary means to implement their ideas. SMEs are therefore supported by the Federal Government both cross-sectorally and on a technology-neutral basis in the realisation and implementation of innovations. A focal point here was the *Central Innovation Programme for SMEs* (ZIM), which was and is being further expanded in 2011 and 2012 due to its success and buoyant demand. In addition small and medium-sized companies engaged in cutting-edge research are being supported through the *"KMU-innovativ"* (innovative SMEs) funding initiative. In 2011 the funding volume was again significantly increased.

Digital age

155. Information and communication technology (ICT), in particular the internet, plays a growing role in innovation, growth and employment. In the framework of its *"Deutschland Digital 2015"* ICT strategy the Federal Government is driving forward the discussion process between the political community, industry and the scientific sector. Last December's National IT Summit, the main platform for this process, took place in Munich.

156. In the area of telecommunications the Federal Government is making every effort to push ahead the development and expansion of up-to-date broadband networks according to requirements. As 99 percent of all households have bandwidths of at least 1 MBit/s, the focus of broadband strategy is moving away from the securing of a basic service across the nation to the creation of high-performance broadband networks offering in excess of 50 MBit/s. In the course of this process of expansion competition is being promoted through technology and supplier diversity (cf. Item 136). In the absence of adequate market solutions the Federal Government supports municipalities, for example by means of the joint Federal-*Länder* programmes *Improving Agricultural Structures and Coastal Protection* and *Improving the Regional Economic Structure* (cf. Item 142).

Growth through innovation in the health sector

157. Due to its innovative strength and employment intensity the health sector is a driver of growth and employment for the German economy. It is one of the main areas of activity in the Federal Government's health research framework programme (cf. 2011 Annual Economic Report). Medical technology is supported both within the framework programme and within the *"KMU-innovativ"* (innovative SMEs) funding initiative. Here it is necessary, with the participation of industry, the scientific sector, health insurance funds, hospitals, and contract medical institutions, to strengthen Germany as a leading supplier of medical technology, reduce obstacles to innovation, and support transfer of technology from the scientific sector to industry.

With its *Health Made in Germany* export initiative the Federal Government is improving the networking of German companies, enabling them to react in a focused manner to complex demand from abroad for health products. Furthermore the marketing of German health products and initiation of contacts in foreign markets is being supported.

Mobility as a high-growth market

158. The Federal Government has created the framework for at least a million electric vehicles to be running on Germany's roads by 2020. It is committed to funding of research and development, for example in the storage technologies sector. The Federal Government explicitly rejects a buyer's premium. The National Plat-form for Electric Mobility (NPE, cf. 2011 Annual Economic Report), established in 2010, in which companies, associations and the scientific sector assemble in a single forum, published its second report last year. According to the latter Germany is on track to becoming the lead market and lead supplier for electric mobility.

In response to recommendations of the NPE the Federal Government ratified the Government *Electric Mobility* Programme in May 2011. The Federal Government intends to make a further billion euros available for electric mobility research and development up to the end of the period of legislation. The government programme makes provision for the creation of a few regional showcases, which are visible internationally due to their size and in which experience of the use of electric vehicles is to be collected. In addition individual research projects will be bundled to create outstanding flagship projects. Other measures such as tax incentives, the opportunity to use special parking spaces, and the public-sector procurement of electric vehicles will improve the regulatory framework for electric mobility.

159. In addition the Federal Government is also funding hydrogen and fuel cell technology to the tune of 700 million euro between now and 2016 under the *National Innovation Programme*. Thus technology-neutral promotion of alternative drive units is taking place.

G. Energy and raw materials – the foundation of safe and competitive growth in Germany

160. An environmentally-friendly, reliable and affordable supply of energy and raw materials is a prerequisite for sustainable growth and the competitiveness of Germany as an economic centre. With its Energy Package of last year the Federal Government made an important step towards restructuring Germany's energy supply. Realignment of energy policy is now being implemented in concrete terms.

The way to the energy of the future – safe, affordable and environmentally-friendly

161. Last year Germany began a new chapter in energy policy. The objective is for renewable energies to account for the main share of energy supply in future. By 2050 at least 60 percent of the total energy requirement and 80 percent of electricity supplied in Germany is to be accounted for by renewable energies. In the light of the Fukushima disaster Germany has also re-evaluated the role of nuclear energy: between now and 2022 a full exit from power production using nuclear power plants will take place on a step-by-step basis in Germany.

162. The strategic orientation for the changeover to renewable energies and to greater energy efficiency was established in the Federal Government's Energy Concept in September 2010. The Energy Package ratified in the early summer of 2011 – an extensive legislative package – saw the first important steps towards the long-term restructuring of energy supply (cf. Overview 5).

163. The energy policy model is to systematically carry out the restructuring of energy supply and at the same time to increase competition in the energy sector and between the energy sources. In the long term all the energy sources must independently face up to the competition in the market so that the most innovative and most efficient technologies gain acceptance. Against this backdrop the Council of Economic Experts quite rightly refers to the energy policy reorientations of recent years as the beginning of a process rather than its completion (cf. GCEE Annual Report, Item 377). It stresses that the energy policy decisions will involve numerous conflicts of interests and objectives which

will raise questions in respect of acceptance, of economic efficiency, and of Germany's industrial competitiveness.

164. The international dimension of the energy and raw materials policy has gained further in importance in the course of the reorientation of energy policy. In view of Germany's high level of dependence on imports of raw materials, close co-operation with its partners is necessary at both EU and international level in order to secure the country's energy supply. Also of importance is international co-operation in the promotion of renewable energies and in increasing energy efficiency and the securing of imports of high-tech raw materials.

Grids, storage, power plants – necessary for the reorganisation of energy supply

165. Besides increased use of load management and improvement of feed-in forecasts for wind and solar energy, energy supply based on renewable energies also needs a high-performance infrastructure embedded in the EU framework which meets the technical requirements of fluctuating production with renewable energy sources. The aspects of grid expansion, storage and power plants are thus of key importance in the expansion of renewable energies.

166. With the rapid construction of new wind and solar capacities additional electricity transmission grids are necessary – particularly between the centres of generation in the north of Germany and the centres of consumption in the west and south. So far expansion by the transmission system operators – also in the opinion of the Council of Economic Experts – is only progressing slowly (cf. GCEE Annual Report, Item 399). The Federal Government has accelerated the approval procedures. For this purpose, among other things the regulatory framework has been optimised for the use of underground cables at 110-kilovolt level and for the planning of high-voltage direct current transmission lines (HVDC). Connection to the grid of offshore farms has been facilitated by making joint connection of wind farms possible. Also, the municipalities through whose territory power lines will be laid in future can agree on financial compensation with the grid operators in the framework of the system of incentive-based regulation. Moreover, for the first time ten-year network development plans are being drawn up for the major power transmission and gas pipeline networks, with affected parties having extensive rights of participation. In addition to this, under certain conditions the Federal Network Agency act as a one-stop shop for the planning and approval procedures for supra-regional transmission lines. Here, too, network operators, municipalities and citizens will be fully involved at an early stage. In the Sustainable Energy Networks Platform, moreover, recommendations on grid expansion, modernisation and security will be developed.

Overview 5: The energy policy decisions

Energy Concept
September 2010
→ strategic focus, targets

6th Energy Research Programme
August 2011
→ new technologies; innovation

Energy Package
Summer 2011:
(7 acts, 1 ordinance)
(incl. Grid Expansion Acceleration Act, amendments to Energy Industry Act and Renewable Energy Sources Act)
and further ongoing implementation
(in respect of networks, power plants, storage facilities, renewable energies and energy efficiency)

Energy and climate fund
→ financing

Monitoring (annual)
→ monitoring of implementation of the measures and targets

167. Power plants and energy storage facilities which can smooth the fluctuating feed-in to the power grid of renewable energies will play an important role in future. The Federal Government will therefore fund the construction of new high-efficiency fossil power plants. Storage facilities are an important component in the creation of a sustainable energy system based on renewable energies. In order to create incentives for appropriate investments, new storage units and modernised pumped-storage power plants have been exempted from grid fees. Nevertheless, the challenges cannot be overcome by policy-making alone. Rather, a social consensus is required that new power plants, new electricity storage facilities and new grids must be built.

Further expansion of renewable energies

168. The expansion of renewable energies in Germany is growing dynamically. Under the Renewable Energy Sources Act (EEG) producers of electricity from renewable energies are permitted to feed the electricity they produce into the power grid (priority feed-in) and receive guaranteed minimum indemnities which as a rule are above the market price. This principle guarantees high security of investment. Other funding instruments, such as the Market Incentive Programme (MAP), the Renewable Energies Heating Act (EEWärmeG), and the Biofuel Quotas Act promote the expansion of renewable energies in the heating and transport sector. The funding instruments have contributed to a rise in investment in the renewable energies sector and hence further growth in gross employment (cf. 2011 Annual Economic Report).

169. Expansion of renewable energies in all energy supply sectors (electricity, heat and mobility) is a key component of the reorientation of energy policy. The target is for 60 percent of our total energy requirement to be accounted for by renewable energies by 2050, and at least 80 percent in the electricity sector. This requires a far-reaching transformation of the existing energy system.

170. In order not to burden the electricity consumer excessively with funding costs in spite of these ambitious expansion targets, cost efficiency of the funding instruments is of great importance to the Federal Government. The Council of Economic Experts also makes reference to this (cf. GCEE Annual Report, Items 425 ff.), and also debates the fundamental effectiveness and cost efficiency of the German feed-in regime and discusses a quota system (cf. GCEE Annual Report, Items 435 ff.).

171. In the Renewable Energies Act (EEG), amended on 1 January 2012, for the first time targeted incentives were established for an intensification of market and system integration of renewable energies. Thus, in particular, a market premium was introduced for electricity from renewable energy sources. It supports producers who do not use the EEG fixed tariff, instead selling electricity from renewable energy sources in the market. This is accompanied by a *flexibility premium* for biogas plants which produce power according to requirements. Additional requirements placed on subsidised power production from biomass should ensure the largest possible contribution to climate protection from bio-energy and safeguard nature conservation interests without increasing the EEG tariff for electricity from biomass. Finally, reduction of the photovoltaic tariffs is also to be continued.

Energy efficiency is the best source of energy

172. Energy efficiency is a key component of the successful refocusing of energy policy: it reduces dependence on imports and cuts energy costs for companies and consumers. The highest priority for the Federal Government is a market-based solution which creates incentives for households and companies to increase energy efficiency.

173. In the product area the Federal Government is making representations at EU level in favour of ambitious implementation and further development of the EU top runner instruments, in particular by means of a combination of minimum standards pursuant to the Eco-design Directive and efficiency labelling. The eco-design requirements should correspond to state-of-the-art technology and should in principle be geared to the most efficient technologies available in the market. Consumer information in the passenger vehicle sector was improved last year. The new CO_2 efficiency scale provides new information about how efficient a vehicle is compared to other models in its class.

174. According to the Federal Government's Energy Concept, about 40 percent of final energy consumption and around a third of CO_2 emissions are accounted

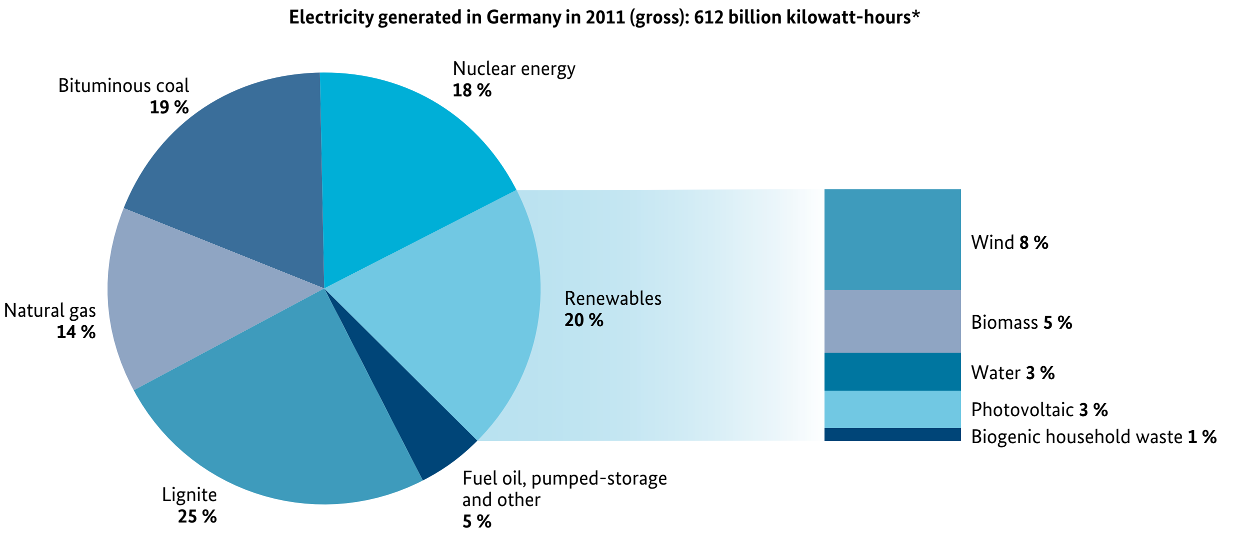
for by the buildings sector. Its potential contribution to the climate protection and energy efficiency targets is correspondingly large. The Federal Government has therefore increased the CO_2 Building Modernisation Programme to 1.5 billion euro per annum from 2012 up to and including 2014. Besides this it is investigating whether the funding in the heating sector can be changed to a market-based and extra-budgetary solution as of 2015. Moreover, the KfW's new *Energy-efficient Urban Redevelopment* funding programme planned as part of the Energy Concept is a start on the path from building to district, not neglecting to take architectural qualities into account. Besides this the Federal Government has started a modernisation offensive for buildings based primarily on counselling and incentives. Between now and 2021 new-builds will be gradually brought up to the nearly zero-energy building standard. The public sector will proceed as a model and will comply with this standard in its new-builds from as soon as 2019. A long-term redevelopment schedule will be drawn up for the building stock which will establish a general framework for the modernisation process up to 2050 which complies with the principle of efficiency. The already very exacting minimum energy standards will be regularly reviewed and increased to the extent that this is economically viable taking into account the burdens for owners and tenants. The energy certificate's role as a source of information will be strengthened.

175. Besides the buildings sector, at approximately 30 percent the transport sector accounts for a considerable share of final energy consumption in Germany. About 16 percent of CO_2 emissions are due to transport. The Federal Government will establish the requirements for achieving the objectives of the Energy Concept in the transport sector by means of measures designed to increase energy efficiency combined with increased use of renewable energies. The mobility and fuel strategy, the Government Electric Mobility Programme and the National Hydrogen and Fuel Cell Technology Innovation Programme are important components of this (cf. Items 158 f.).

Achieving the objective by means of energy research

176. The Federal Government is supplementing its energy and climate policy with improved funding of research and development for sustainable energy technologies. The aim of the funding policy is to make these technologies more cost-effective and thus smooth the way for rapid market penetration.

Figure 14: Gross power production in Germany



* Provisional figures (as 14.12.2011), estimated in some cases. Totals deviate due to rounding.

Sources: Working Group on Energy Balances (AGEB), German Energy and Water Industry Association (BDEW)

In August 2011 the Federal Government therefore ratified the Sixth Energy Research Programme (cf. Box 9).

Safeguarding competition and affordability

177. Germany is one of the best performing and most economically successful countries in the world. Electricity should be available at any time of day or night, in any quantity required, and at affordable prices. A fully-functioning internal market for electricity and gas in Europe contributes to the affordability and security of the German energy supply. The foundation must therefore be laid at EU level for an integrated pan-European energy network. This is also emphasised by the Council of Economic Experts (cf. GCEE Annual Report, Item 403).

178. The restructuring of the energy supply is a task for society as a whole. In order for it to receive broad-based support throughout the population the restructuring must take place in a cost-effective manner and must be based on sustainability, and the costs must be shared fairly. Consumers must not be overwhelmed by rising energy prices.

179. Many industry sectors in Germany which process and supply essential commodities and raw materials are energy-intensive. A prerequisite for the growth and competitiveness of these companies is that power supply remains affordable in Germany. In order to expose impropriety in the pricing process in the wholesale market and promote competition in the electricity markets the Federal Government will therefore set up a market transparency authority for wholesale trading of electricity and gas.

180. In addition to this the Federal Government is partly exempting certain power-intensive companies from the additional costs arising from the refocusing of energy policy. For example, they are exempted from network fees. Also, in future the Renewable Energies Act reallocation charge will be considerably reduced

Box 9: The Sixth Energy Research Programme: *Research for environmentally-friendly, reliable and affordable energy supply*

With its Sixth Energy Research Programme the Federal Government is supporting research and development, among other things in the renewable energies and energy efficiency sectors. For this purpose it is making about 3.5 billion euro available from 2011 to 2014. This is 75 percent more than for the period from 2006 to 2009. Of this increase only 685 million euro is being financed out of the energy and climate fund. The Sixth Energy Research Programme concentrates on four main areas:

- **Strategic focus of the subsidies**
  The central areas of the research are renewable energies, energy efficiency, energy storage technologies, grid technology, integration of renewable energies into the energy supply system, and the interaction of these technologies.

- **Inter-ministerial co-operation in selected important areas**
  The first joint funding initiative, energy storage, has already been initiated. The sum of 200 million euro has been made available for this. Further joint initiatives relating to *"networks and solar construction – energy-efficient city"* are to follow.

- **Expansion of international co-operation**
  This relates in particular to the cross-linking of the research activities within the EU and the co-operation in the framework of the energy technology network of the International Energy Agency.

- **Co-ordination of energy research activities**
  This involves expansion and strengthening of the *energy research policy co-ordination platform.*

for a large number of companies – in particular small and medium-sized ones.

181. With the *energy and climate fund* (EKF), as early as 2010 the Federal Government had created a financing base allowing it to finance the funding of environmentally-friendly, reliable and affordable energy supply along with measures related to international climate and environmental protection. In 2011 the Energy Package put the EKF on a new footing. On the income side, from 2012 onwards the EKF will receive all the proceeds from the auction of greenhouse gas emission certificates. In return, from 2012 the funding of electric mobility and many programmes related to energy and climate policy will be financed by the EKF. For example the latter include measures related to building modernisation, national and international efforts to combat climate change, energy research, and the funding of international energy and raw materials partnerships as well as the funding of new high-efficiency fossil power plants. From 2013 funds will also be made available from the EKF to pay for power-intensive companies to offset the cost of emissions trading-related electricity price increases.

Reviewing objectives and implementation of the energy policy decisions

182. The environmental compatibility, reliability and affordability of energy supply are continuously reviewed in the course of implementation of the Energy Package and the Energy Concept in order to allow readjustments where necessary. In October 2011, therefore, the Federal Government approved the *energy of the future* monitoring process (cf. Box 10).

Securing raw material sources in the face of the competition

183. Sustainable growth and prosperity require a secure supply to German industry of metal and mineral commodities and an efficient approach to dealing with these raw materials. The Federal Government is therefore implementing the Raw Materials Strategy ratified in October 2010 in accordance with the principles of its economic policy: industry is primarily responsible for securing its supply of raw materials; the Federal Government supports this, among other things with international partnerships. In acknowledgement of the growing importance of secondary raw materials for the supply of raw materials to German industry, the Federal Government has improved the regulatory framework for increased recycling and higher resource efficiency and last year approved the draft of a new Closed Substance Cycle and Waste Management Act (KrWG). In addition the Federal Government will approve the German resource efficiency programme, ProgRess. This is planned for the beginning of 2012.

184. A further important step in the framework of the raw materials strategy was taken last year with the intergovernmental agreement between Germany and Mongolia on co-operation relating to raw materials, industry and technology. This agreement represents Germany's very first raw materials partnership. The aim of raw materials partnerships is to secure the supply of raw materials to German industry and at the same time to support the sustainability of the raw materials industries in the producer countries. The agreement creates a political framework in which companies can make their own agreements independently. The planned focal points of the co-operation with Mongolia include increasing raw materials and resource efficiency locally, implementation of environmental and social standards in raw materials production and processing, creation of industry clusters, and improvement of the climate for investment and innovation. Negotiations with Kazakhstan on a raw materials treaty are also at an advanced stage.

185. Moreover, the Federal Government is increasing transparency in the raw materials sector, for example by means of the international *Extractive Industry Transparency Initiative* (EITI). Thus it is meeting the requirements for good governance, fighting corruption, and sustainable exploitation of resources.

Box 10: *Energy of the future* monitoring process

- Alongside the monitoring process a commission of energy experts is being set up whose opinion is taken into account in the drafting of the Federal Government's monitoring report and is attached to the latter as an appendix.
- An office will be set up at the Federal Network Agency for the purpose of organising the monitoring process.
- The annual monitoring report will be drawn up for the first time at the end of 2012 based on the energy statistics data for 2011.
- The summary progress report, which will be drawn up every three years, will be published for the first time in 2014. It is based on a multiple-year database and in this manner contributes to the identification of reliable trends.
- The report of the Federal Government will be forwarded to the German Bundestag and to the Bundesrat. In addition the Federal Government will increase the scope of its dialogue with the public on the programme of measures.

H. Accepting international responsibility and opening markets

International co-operation creates sustainable global markets

186. Industry needs a stable and open environment for growth and competition. At global level this is mainly achieved by means of international agreements and groupings. The G8 and G20 in particular contribute to international understanding and improved integration of international markets. The Federal Government also works at international level to achieve a stable and reliable regulatory framework for economic activity.

Besides global trade and the financial markets this also applies in particular to the international commodities markets and a transparent exchange rate policy with market-based exchange rates. In the *"Framework for Strong, Sustainable and Balanced Growth"* the Federal Government makes every effort within the G20 to reduce excessive global imbalances and in particular to combat the structural causes of current account surpluses and deficits. At the G20 summit in Cannes a new action plan was adopted to this end. Meanwhile developing countries are supported in becoming new global growth centres. In addition the Federal Government works within the G8 and G20 for sustainable and climate-friendly growth and towards strategies for low-carbon economic growth, for example by means of renewable energies and higher energy efficiency.

The G8 summit held in Deauville in May 2011 was dominated by the process of democratisation in North Africa and the Arab world. The *Deauville partnership* announced by the G8 is intended to support this process (cf. Box 11). The focal point of the discussions at the G20 summit held in Cannes in November 2011 was the state of the global economy, in particular the debt problem in parts of the eurozone. The heads of state and government of the G20 supported the eurozone in its resolutions adopted at the European Council on 26 October. In particular at Germany's behest the G20 reiterated that stable public finances are a key requirement for sustainable growth. In addition a series of resolutions were adopted relating to supervision and regulation of financial markets and the global currency system (cf. Box 11). The G8 and the G20 are committed to the negotiating mandate of the Doha Round of the WTO.

Growth through more competition in international markets

187. Free access to high-growth global markets is essential for continuous economic growth in Germany and throughout the world. The Federal Government is therefore maintaining the goal of successfully concluding the Doha Round. The multilateral trading system of the WTO contains reliable rules and ensures equal rights for all WTO members.

An important result of the 8th WTO Ministerial Conference of December 2011 was the WTO members' approval of Russia's accession. Following the negotiations, which proved difficult to the last, the accession process started in 1993 has now been successfully concluded. Russian accession to the WTO will further stabilise the policy environment in Russia, intensify bilateral commercial relations, and facilitate access to the high-growth Russian market for German exports.

188. In view of the outstanding agreement in the Doha Round the conclusion of bilateral EU free trade agreements with important growth regions is of special importance. The most important aim of the EU trading strategy is to conclude comprehensive trade agreements with important emerging economies in order to improve market access for EU companies.

Box 11: Main results of the G8 and G20 summits in 2011

G8 summit in Deauville (26 – 27 May 2011)

- Discussions about measures which might support the process of democratisation and reforms in North Africa and the Middle East (Arab Spring); creation of the *Deauville Partnership* with the following economic policy components: growth through greater integration of the region in the global economy together with expansion of trading and investment by means of increased market deregulation; initial and continuing occupational training in order to support modernisation of the economies in the region, among other things with the German *Partnership for Employment* in which companies and unions are to be included and with the creation of three funds by the Federal Government to support democracy, training and industry with a total value of about 34 million euro;
- commitment by the G8 to the highest possible safety standards in nuclear technology throughout the world;
- exchange between members of the G8 on the state of the global economy, on green growth, on climate issues, and on the economic, social and political aspects of the future of the internet;

G20 summit in Cannes (3 – 4 November 2011)

- Development of the *Cannes Action Plan* for Growth and Jobs, under which the G20 agreed on measures to strengthen the foundations for growth; confirmation of the Toronto Objectives of the industrialised countries on budget consolidation;
- setting up of a task force to safeguard employment, devoted in particular to reducing youth unemployment;
- reaffirmation of the decision made at the G20 summit in Toronto to desist until the end of 2013 from creating new trade and investment restrictions or to reduce such measures;
- understanding on reform of the global currency system in order to make the latter more stable and resilient: an action plan for the development of local bond markets in newly-industrialising and developing countries, strengthening of multilateral supervision by the IMF, and a joint understanding on dealing with international capital flows;
- rulings on financial market reforms, focusing on the approach to systemically important financial institutions and supervision and regulation of shadow banking; agreement on intensified supervision of and a harmonised regulatory framework for the (cross-border) insolvency of globally-active system-relevant financial institutions (cf. Items 87 to 92);
- improvement of the effective functioning of the commodities markets, in particular by means of greater transparency; action plans for agriculture/global nutrition; development policy and the fight against corruption; energy and climate policy and questions of global governance.

From the German point of view the priority is the South-East Asian and Latin American regions. The first positive result of this strategy is the provisional application since 1 July 2011 of the free trade agreement with South Korea. The trade agreements with Columbia and Peru and with Central America have been concluded and it is anticipated that they will become effective in the first half of 2012 following successful ratification. Conclusion of the ongoing negotiations on free trade agreements with Singapore and Canada is similarly expected in the course of 2012.

189. An essential component of modern free trade agreements is the removal of non-tariff barriers to trade. Removal of the latter is also being pursued in the framework of bilateral co-operation agreements with third countries. The Commission for Co-operation on Standardisation was formed during German-Chinese intergovernmental consultations. Harmonised standardisation at international level contributes to quality assurance, intensifies competition through the reduction of implicit barriers to trade, and facilitates technical co-operation.

190. Export credit guarantees of the Federal Government (Hermes insurance) offer protection against payment default in export transactions for which private credit insurance companies do not provide insurance cover. In 2011 export transactions worth about 29.8 billion euro were covered. The instrument has a particularly positive impact on export and employment for small and medium-sized exporters. Particular attention is therefore given to the instrument's usefulness for SMEs as the Hermes insurance system is developed further. In 2011 an accelerated decision-making process was introduced in this connection called Buyer Credit Cover Express, which made possible a decision within four bank working days for bank-financed export transactions with small contract volumes.

191. A further element of its efforts to promote foreign trade and investment, the Federal Government extends investment guarantees against political risks for foreign projects of German companies. Due to heavy demand the budgetary framework for this was sharply increased at the beginning of 2011 by 10 billion euro to 50 billion euro. Numerous guarantees were extended for countries not previously covered, or only seldom covered, such as Sierra Leone, and also Malaysia and Colombia. The guarantee practice was further developed in close consultation with German industry, so that guarantees are now also provided for loans with terms under five years – provided this matches project requirements. In 2011 a guarantee providing cover against isolated terrorist attacks was also offered for the first time.

Development through investment

192. In the framework of the G20 the Federal Government also takes on development responsibility. Thus within the G20 process it is driving forward the issue of financing of small and medium-sized companies in developing countries as well as private investment and employment. At the same time the Federal Government supports responsible financing practices in the microfinance sector based on strict ethical standards.

Within the development co-operation the Federal Government promotes inclusive business models and sustainable foreign and local investment in developing countries, for example by means of counselling on improvement of the economic environment, innovation and technology assistance, SME financing, and through development partnerships with industry, for example with the *DeveloPPP programme*. In addition the *Deutsche Investitions- und Entwicklungsgesellschaft* (DEG) participates in co-financing of feasibility studies together with assessment and consultancy fees on a pro rata basis. Specialists sent to German chambers, business associations and chambers of commerce help to improve dovetailing of development policy and industry. *A manager training programme* aims to improve the management skills of managers from selected developing countries, and a practice partnership programme aims to enhance the practical relevance of the academic training in developing countries.

Lasting co-operation through entrepreneurial commitment

193. Assumption of social responsibility by companies and citizens strengthens the social market economy at national and international level. The term Corporate Social Responsibility (CSR) stands for responsible behaviour in the core business. CSR describes an integrated business concept which includes all the voluntary social, ecological and economic contributions of a company to the assumption of social responsibility which go

beyond compliance with statutory regulations and which include the interrelationships with the stakeholders. As part of the CSR Action Plan the Federal Government is strengthening CSR in international and development policy contexts. The Federal Government is promoting the dialogue on this issue in the relevant international forums such as the EU, the UN, and the G8 and G20.

With a view to stepping up CSR at international level, the OECD Guidelines for Multinational Enterprises have been revised. With this measure the Federal Government is promoting responsible entrepreneurial behaviour in respect of foreign investment, thus preventing negative consequences for society, the economy and the environment. The most important new areas covered are human rights, supply chains and duty of care for companies.

The Federal Government is promoting entrepreneurial commitment outside of the core business with its national commitment strategy. The Federal Government is working with the network of socially committed companies known as *"WIE – Wirtschaft. Initiative. Engagement."* ("Industry. Initiative. Commitment.") in order to achieve the objectives of the national commitment strategy.

II. The Federal Government’s projection for Germany

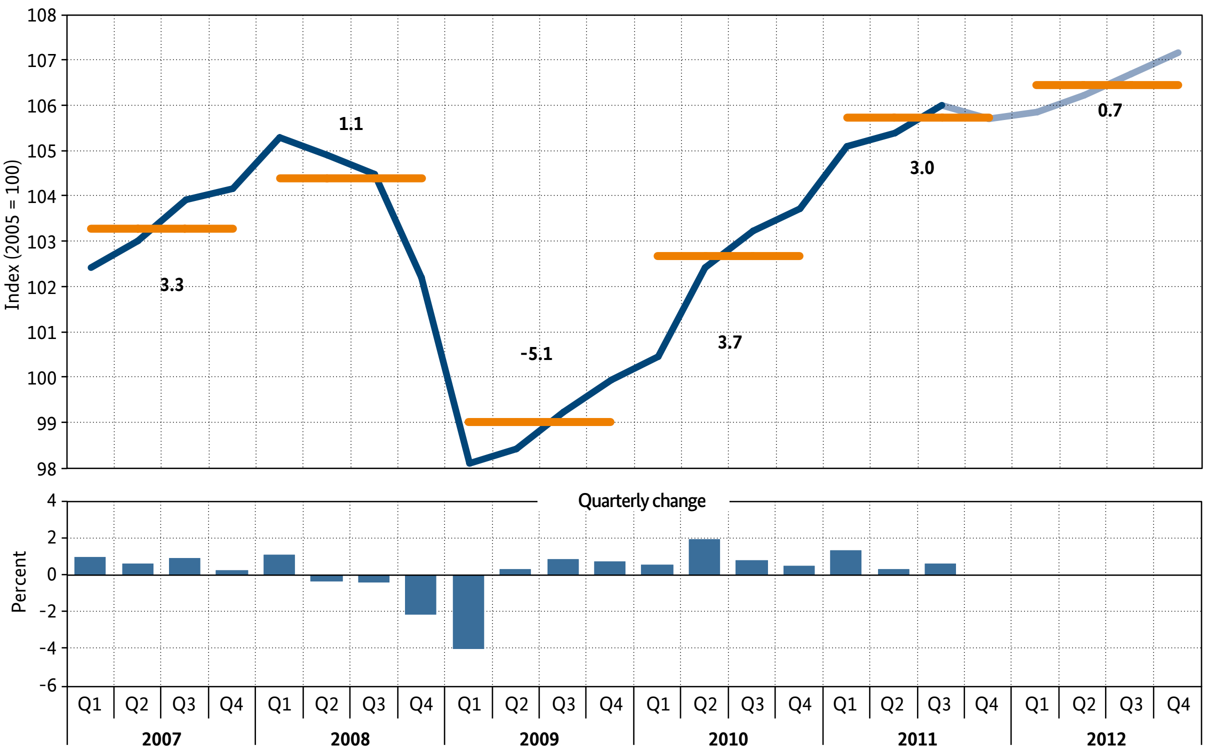
Temporary slowdown in growth

194. In the course of last year, economic activity in Germany regained the pre-crisis level of spring 2008. The post-crisis recovery process was thus even more dynamic than the Federal Government had anticipated a year ago (cf. Box 12). The upswing was – not least in the international comparison – very powerful indeed: gross domestic product expanded by 3.0 percent in 2011, following an increase of 3.7 percent the year before. The manufacturing sector was the main driving force for growth. However, in the course of last year the level of debt in a number of industrial countries – often coupled with doubts about their competitiveness – engendered tangible uncertainty on the capital markets. As a result, the expectations in the performance of the German economy clearly fell in the second half of 2011. Growth slowed. The ongoing uncertainty resulted in a stronger slowdown in growth than previously assumed.

In its annual projection for 2012, the Federal Government expects a temporary phase of cyclical weakness, but not a recession. As the year progresses, the Germany economy will return to a faster pace of growth. The Federal Government anticipates that price-adjusted gross domestic product will grow by 0.7 percent in annualised terms (cf. Figure 15). This implies that the German economy will continue to grow rather more strongly than the eurozone as a whole. The assessment of the overall economic development is largely in line with that of the Council of Economic Experts (GCEE Annual Report, Items 108 ff.).

Growth in Germany was already being mainly driven by the domestic economy in the last two years. And the forces driving growth will shift further across to the domestic economy. As a result of the significant slowdown in growth in the international and, in particular, in the European context, exports are only likely to

Figure 15: Development of gross domestic product in Germany (price-adjusted)



Blue line: Quarterly changes in previous year’s prices, adjusted for seasonal and calendar effects
Orange line: Yearly averages in previous year’s prices, year-on-year changes in percent
Blue columns: Changes in percent, adjusted for seasonal and calendar effects

Source: GDP trends until Q3 2011: Federal Statistical Office; own calculations record a moderate expansion this year. In view of the dynamic development in imports, the calculated contribution to growth from net foreign demand, which derives from the difference between exports and imports, will be negative. In contrast, consumer spending will make an appreciable contribution to growth. And the environment for investment remains favourable. Since the price-adjusted gross domestic product will record a moderate increase and since employment will continue to pick up, albeit at a slow rate, the coming year can be expected to see a slight increase in productivity. Gross domestic product will rise by an annual average of 2.2 percent in current prices. For cyclical reasons, corporate income and income from assets will expand somewhat more slowly than national income.

195. The 2012 Annual Projection is based on the following assumptions:

– According to forecasts by international organisations, the global economy will grow at a real rate of approximately 3 ¼ percent. World trade is likely to expand by roughly 3 ½ percent.

– As usual, technical assumptions regarding oil prices and exchange rates during the projection period are based on the averages posted during the final weeks prior to the forecast. Thus the projection assumes an average annualised price of roughly 109 US dollars per barrel for Brent crude oil (approx. 2 percent lower than the average for 2010) and an exchange rate of roughly 1.31 US dollars to the euro (roughly 6 percent lower than the average for 2010). It is also assumed that the interest rate applied by the European Central Bank to its main refinancing operations will remain at its current level of 1 percent until the end of the projection period.

– Total payroll (adjusted for inflation) is expected to remain in line with the trend in total productivity growth.

– The financial sector will remain stable; the influence of the debt crisis will weaken significantly in the course of the year.

– The projection takes into account all of the economic and fiscal policy measures adopted prior to the completion of this Annual Economic Report.

196. The Federal Government's annual projection is based on the central assumption that that progress will continue to be made on the solution to the debt crisis in Europe and that the uncertainty on the markets will gradually dissipate. The main risk to economic development in 2012 is undoubtedly a worsening of the crisis. The Federal Government shares the view of the Council of Economic Experts that the uncertainties affecting the cyclical development in 2012 are especially marked due to the debt problems in the eurozone. The Council quantifies risk scenarios for various patterns of the debt crisis. Nevertheless, the occurrence of the risk scenarios is regarded as significantly less likely than the base scenario (cf. GCEE Annual Report, Items 122 – 125). Further risks lie in an even stronger cooling down of the global economy, for example if the United States proves unable to return to a viable course of growth. On the other hand, a rapid resolution of the debt crisis also unquestionably represents an opportunity for a more positive development. If the uncertainty amongst the market participants disappears more quickly than has been assumed, economic activity could make an even swifter return to a faster pace of growth. The self-reinforcing effects in the domestic economy driving from good developments on the labour market and in income, together with a monetary policy which continues to be oriented to expansion worldwide, could produce a more favourable macroeconomic environment. However, the expansionary monetary policy worldwide and the related high level of liquidity do contain risks. They could exacerbate the medium-term risks of inflation and the propensity for the formation of bubbles.

Fragile global economic environment

197. In the course of last year, the rate of global economic expansion slowed appreciably. This had been generally expected as the process of catching-up following the global financial and economic crisis came to an end. Furthermore, there was another clear increase in government borrowing in the advanced economies during the crisis (cf. Figure 16) in order to stabilise the financial system and to boost the economy. Together with a monetary policy which is more strongly oriented to price stability in the emerging economies, the ensuing necessary policy of consolidation has reduced the short-term stimuli for world economic growth.

Overview 6: Selected key figures for macroeconomic trends in the Federal Republic of Germany[1]

	2010	2011	Annual projection 2012
	Year-on-year changes in percent		
Gross domestic product (GDP), output approach			
GDP (price-adjusted)	**3.7**	**3.0**	**0.7**
Employment (domestic)	0.5	1.3	0.5
GDP per person employed	3.2	1.6	0.1
GDP per hour worked	1.4	1.2	0.5
Unemployment rate in percent (according to national accounts) [2]	*6.8*	*5.7*	*5.4*
Unemployment rate in percent (as defined by the Federal Employment Agency) [2]	*7.7*	*7.1*	*6.8*
GDP, expenditure approach (in current prices)			
Consumption expenditures			
Private households and non-profit institutions	2.6	3.7	3.0
Government	2.7	2.7	3.2
Gross fixed capital formation	5.9	7.9	2.4
Changes in inventories etc. (in billion euro)	*-4.0*	*-8.3*	*-11.5*
Domestic demand	3.8	4.1	2.8
Net foreign demand (in billion euro)	*135.5*	*133.5*	*122.0*
(in percent of GDP)	*5.5*	*5.2*	*4.6*
Gross domestic product (nominal)	**4.3**	**3.8**	**2.2**
GDP, expenditure approach (price-adjusted)			
Consumption expenditures			
Private households and non-profit institutions	0.6	1.5	1.2
Government	1.7	1.2	1.0
Gross fixed capital formation	5.5	6.5	1.5
Machinery and equipment	10.5	8.3	2.0
Construction	2.2	5.4	0.8
Other plant and equipment	4.7	4.8	5.0
Changes in inventories etc. (contribution to GDP growth rate) [3]	*0.6*	*-0.1*	*-0.1*
Domestic demand	2.4	2.2	1.1
Exports	13.7	8.2	2.0
Imports	11.7	7.2	3.0
Net foreign demand (contribution to GDP growth rate) [3]	*1.5*	*0.8*	*-0.3*
Gross domestic product (real)	**3.7**	**3.0**	**0.7**
Price trends (2000 = 100)			
Private consumption expenditures [4]	1,9	2,1	1,7
Domestic demand	1,4	1,8	1,7
Gross domestic product [5]	0,6	0,8	1,5
Distribution of gross national income (GNI)			
(resident concept)			
Wages and salaries	2.5	4.5	2.4
Entrepreneurial and property income	10.5	1.5	2.3
National income	5.1	3.5	2.3
Gross national income	4.0	3.5	2.2
Additional information (resident concept):			
Persons employed	0.5	1.3	0.4
Gross wages and salaries – total	2.7	4.8	2.8
– per employee	2.2	3.4	2.4
Household disposable income	2.9	3.3	3.0
Savings rate in percent [6]	*11.3*	*10.9*	*11.0*

1 Up to 2011, preliminary figures from the Federal Statistical Office as of 11 January 2012;
2 Based on total number of persons employed;
3 Contribution to GDP growth rate;
4 Year-on-year changes in the consumer price index: 2010: 1.1 percent; 2011: 2.3 percent; 2012: 1.8 percent;
5 Year-on-year changes in unit labour costs per person employed: 2010: -1.2 percent; 2011: 1.5 percent; 2012: 1.8 percent;
6 Savings as a percentage of household disposable income including pension fund reserves.

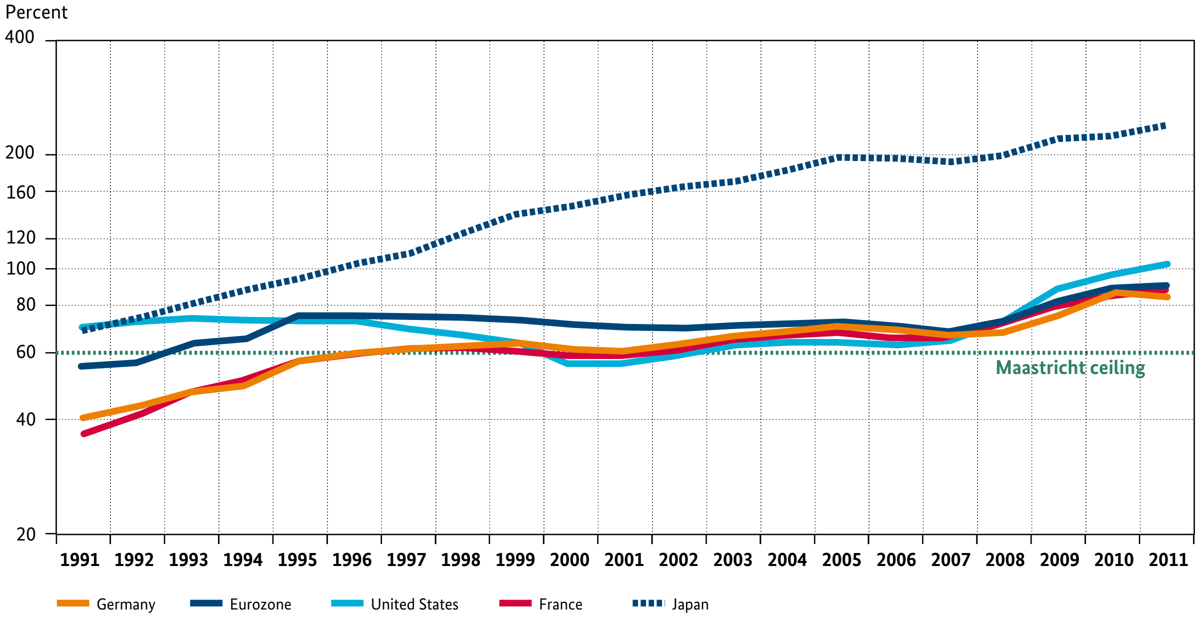
Furthermore, the situation on the international financial markets deteriorated substantially in the course of 2011. Share prices collapsed, bond yield spreads widened, premiums for credit default insurance for bonds from banks and certain countries rose, and the volatility on the financial markets increased. The indicators of confidence fell all round the world. A continuation or a worsening of this widespread uncertainty is likely to be the central risk factor for the global economy in the period covered by the projection. When the environment is sensed to be risky, decisions to buy or to invest tend to be delayed. Furthermore, the risk premiums on private and public securities rise, and the conditions for financing for companies and the public sector tend to worsen.

198. The global economic environment therefore remains fragile at the beginning of 2012. The global economy is only expanding moderately in the 2011/2012 winter semester. This finding can be derived from the declining leading indicators like the OECD's Composite Leading Indicator and the ifo Institute's global economic climate indicator. The annual projection assumes a gradual and continuous solution to the debt crisis in Europe and a restoration of confidence. It also assumes a normalisation of monetary policy in the emerging economies. For this reason, the pace of global expansion is likely to start picking up again in the course of the year. The Federal Government thus largely concurs with the Council of Economic Experts' assessment of the global economic environment (GCEE Annual Report, Items 58 ff.). As an annual average, the global economy – driven by the continuing high rates of growth in the emerging economies – is likely to expand by around 3 ¼ percent.

The expansion of world trade also slowed in 2012 compare with the year before. Due to the underlying economic dynamism in the emerging economies and the declining global uncertainty, the development over the year as a whole will reflect a slightly positive trend. The upward trend deriving from the increasing integration of emerging economies into world trade will remain in place.

199. In the advanced economies, the excessive private and public-sector debt will dampen the recovery. In the United States, the hesitant process of recovery will continue. The private citizens will need to reduce their high level of borrowing, and this will have a dampen-

Figure 16: Public sector debt in advanced economies in relation to nominal gross domestic product (in percent) since 1991



Source: International Monetary Fund

ing effect on consumption. The fiscal measures which have so far provided a stimulus will expire. The necessary reduction of public-sector borrowing, which is higher than for example in the eurozone (cf. Figure 16), will also slow growth down in the short term. Furthermore, the problems in the real estate sector and on the labour market will continue to slow the economy. However, since corporate profits will increase sharply due to high improvements in productivity, investment is likely to boost growth. Overall, economic growth in the United States will remain moderate in 2012.

In Japan, economic development was affected by the repercussions of the natural and nuclear disaster in March 2011. The Japanese economy has been recovering since May 2011. Nevertheless, Japan's economic output declined in overall terms last year. This year, economic growth in Japan will be relatively strong, in contrast to the global trend. This recovery will be driven by the investment from the wide-ranging reconstruction programme. Risks for Japan derive from the increasing level of government borrowing, which according to the IMF now stands at more than 230 percent of gross domestic product. In the light of the clear under-utilisation of capacity across the economy, the deflationary pressure is likely to continue.

In the eurozone, the debt problems of certain member states which had been smouldering for quite some time flared up last year and caused a crisis of confidence. This means that major cyclical risks which had been feared at the beginning of last year did materialise. The recovery was slowed. The financing conditions worsened. But developments diverge greatly. The great need for consolidation in certain member states of the eurozone necessitates a reduction in spending on consumption and investment. As a result of this adjustment process, economic development in the eurozone will slow down markedly in the short term. Due to the necessary structural reorientation, the subsequent recovery will be slower than in most of the other advanced economies. Thanks to their high degree of economic integration with the eurozone, some of the central and eastern European trading partners will also suffer. Despite this, economic growth in the European Union is likely to be somewhat higher than in the eurozone.

200. In the emerging economies, the short-term upward trend will be slowed both by the reduction of the expansionary monetary environment and by the weakness of the advanced economies. Despite this, the underlying growth dynamism in these regions is likely to continue.

Economic growth in China will be more moderate than in recent years. In the other emerging economies of south and east Asia, whose markets have also gained appreciably in significance for German exporters in recent years, the current weakening should be reversed somewhat earlier. The cyclical development in the countries of Latin America will also slow somewhat in 2012. Despite the slight drop in commodities prices, the Russian economy is likely to see a moderate expansion.

External economic environment hitting German exports – domestic demand boosting imports

201. Due to the brisk recovery of the global economy, German exports rose sharply in the last two years and returned to pre-crisis levels. Despite the dynamic development in trade with emerging economies like China, the eurozone continues to be Germany's main trading partner. Roughly 40 percent of Germany's exports went to the eurozone in 2011. The slower development in the world economy in the 2011/2012 winter semester, and in particular the current weakness in growth in the eurozone, will dampen the development of German exports. This is suggested by the declining trend in indicators like new manufacturing orders from abroad, and the export expectations in the ifo business climate survey. Thanks to the expected improvement in the global economy and world trade in the course of 2012, however, German exports will pick up steam again. Overall, Germany's export markets will grow at a very restrained pace this year. However, German export companies are likely to be able to retain their position on the international sales markets and to expand their exports in line with market developments. The competitive advantage enjoyed by German companies in terms of price will be maintained in 2012. The product range of German exporters is largely oriented to technically sophisticated industrial goods, which is why demand for it has increased as the world economy has picked up, and especially as the emerging economies have developed. In the period of this projection, this effect will be less positive than it has been, due to the slower growth in the emerging economies. Given these developments, German exports are temporarily expected to see a rather moderate increase, at 2.0 percent

in real terms this year. Here, export prices will expand by a similar degree to import prices. Many exporters will be able to pass on the slightly higher prices for imported intermediate goods in their export prices.

The weaker growth in exports contrasts with stronger stimuli from domestic demand. In view of the positive development in domestic demand, 3.0 percent more goods and services will be imported in real terms on an annualised basis in 2012. Imports will expand more strongly than exports. In numerical terms, therefore, net exports are expected to make a negative contribution to growth in 2012 of -0.3 percentage points in real terms.

Moderate development in investment

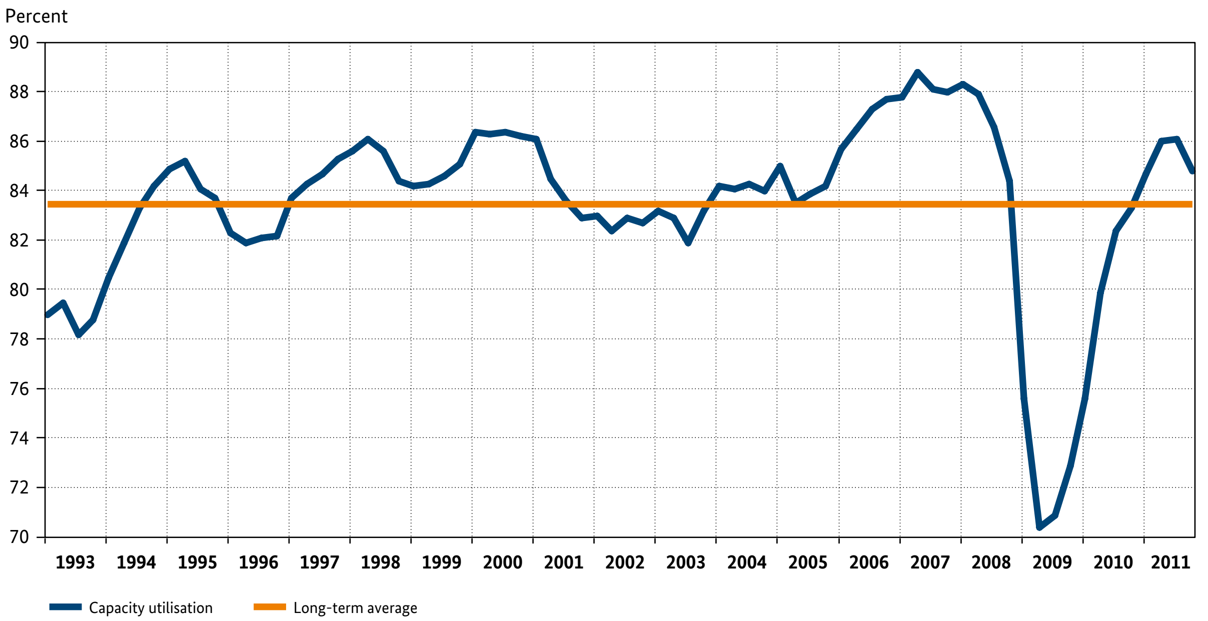
202. Thanks to the dynamic development of German exports, companies in the export-oriented manufacturing sector were able to increase their levels of capacity utilisation significantly in 2011. Latest figures have shown a fall in the level of capacity utilisation in this sector, but it remains slightly higher than the longer-term average (cf. Figure 17). Together with the darkening of the global economic environment, this suggests that weaker investment activity should be expected in the projection period. This is also suggested by short-term indicators like output and domestic turnover of capital goods manufacturers.

The financing conditions for German firms will continue to be favourable, with interest rates staying low. Banks and companies continue to assess the conditions for the granting of credit in Germany positively. This is confirmed by the latest surveys. Also, German firms still dispose of good internal financing possibilities due to their strong profits in the past.

For this reason, investment in plant and equipment is likely to grow by 2.0 percent in real terms this year. According to the survey by the Association of German Chambers of Industry and Commerce of autumn 2011, the companies' intentions to invest are substantially more optimistic than their export expectations. This survey says that capacity expansion and environmental protection will become even more important motives for investment.

203. Investment in construction rose more rapidly last year than at any time since 1994. Private-sector investment in non-residential construction will continue to

Figure 17: Capacity utilisation in the manufacturing sector (ifo) in percent since 1992



Source: ifo Institute

expand slightly this year. Private-sector residential construction is also likely to expand. Here, the favourable financing conditions, particularly in the form of low mortgage interest rates, will provide a stimulus. Also, the development in employment and income will boost demand for residential property. Furthermore, in view of the uncertainty on the financial markets, the preferences of investors are likely to shift further towards real estate. In addition, the housing stock will be further modernised, particularly in terms of its energy performance. The finishing trades in particular will benefit from this. In the public sector, by contrast, investment in construction will normalise again following the end of the measures from the Future Investment Programme. Overall, the Federal Government expects real construction investment to rise slightly by 0.8 percent this year. Real gross fixed capital formation will expand at a rate of 1.5 percent this year.

Resilient labour market

204. The upward trend on the German labour market has now been ongoing for several years. The rise in employment continued at a high pace last year. At 41.1 million, the number of people in gainful activity reached a new high. Employment subject to social security contributions expanded by 660,000 people: more strongly than overall gainful activity. Unemployment dropped below the three-million mark on average for the year, recording the lowest level since 1991. The increased dynamism on the labour market and permeability of the labour market is particularly benefiting the long-term unemployed, young people and older people. The number of long-term unemployed people has dropped by more than 40 percent since 2005. The unemployment rate for young people (aged 15 – 25) stood at 5.9 percent in 2011, well below the general unemployment rate. Since 2005, the number of older people (aged 50 – 65) employed in jobs subject to social security contributions has risen by 2 million to 7.7 million (as of June 2011).

The Federal Government expects the positive development on the labour market to continue in 2012. This is indicated for example by the ongoing improvement in the "BA-X" indicator of the Federal Employment Agency, which follows corporate demand for labour. The ongoing drop in structural unemployment is also creating scope for a lasting reduction in unemployment. However, the expected weakening of growth is likely to significantly reduce the pace of the growth in employment. Also, the increasing scarcity of labour, especially in the field of well-trained skilled workers, will make it more difficult for vacancies to be filled.

Overall, the Federal Government anticipates a further increase in gainful activity by roughly 220,000 people, or 0.5 percent, in annualised terms. This year is expected to post a new record for employment. Employment subject to the payment of social security contributions will again expand more strongly than gainful activity in general. Almost all the new jobs are subject to social security contributions. In parallel to the development in employment, the drop in unemployment will tend to be smaller than last year. The Federal Government expects unemployment to fall by 100,000 as an average for 2012. This equates to a drop in the unemployment rate of 0.3 percentage points to 6.8 percent. It should in particular be stressed that Germany now has one of the lowest unemployment rates, not least in the European comparison. The internationally comparable unemployment rate as measured by the International Labour Organization (ILO) will drop by 0.3 percentage points to 5.4 percent in 2012.

As happened last year, the increase in gainful activity is likely to be significantly greater than the decline in unemployment. It will in turn be possible to fill some of the newly created jobs with workers from the hidden reserves. In the light of the expected decline in the working population, the ongoing mobilisation of the labour market's hidden reserves is especially welcome.

Stable prices

205. The rise in the consumer price level in Germany was slightly higher than the European Central Bank's target inflation rate last year. The main reason for this development was rising energy costs at the beginning of the year. The average oil price in 2011 was roughly 40 percent higher than the 2010 average. The core inflation rate – i. e. the rise in consumer prices excluding the prices of energy and seasonal foods – was moderate at 1.5 percent. In view of the technical assumption of a constant oil price of 109 US dollar per barrel, energy costs only make a small contribution to inflation in the 2012 annual projection. The weakening global economic growth counters the risks of inflation

which could derive from the ample global liquidity. The 1.8 percent rise in the consumer price level in 2012 is thus back inside the European Central Bank's target range. Inflationary expectations so far are stable. At 1.6 percent, the core inflation rate – also affected by the continuing favourable domestic economic development – will be higher than in recent years. The scope for companies to pass on price rises will increase this year. However, against the background of the wage agreements, which are expected to be in line with the needs of stability, the inflationary pressures in the domestic economy will be moderate. There will be a restrained increase in unit wage costs per employee.

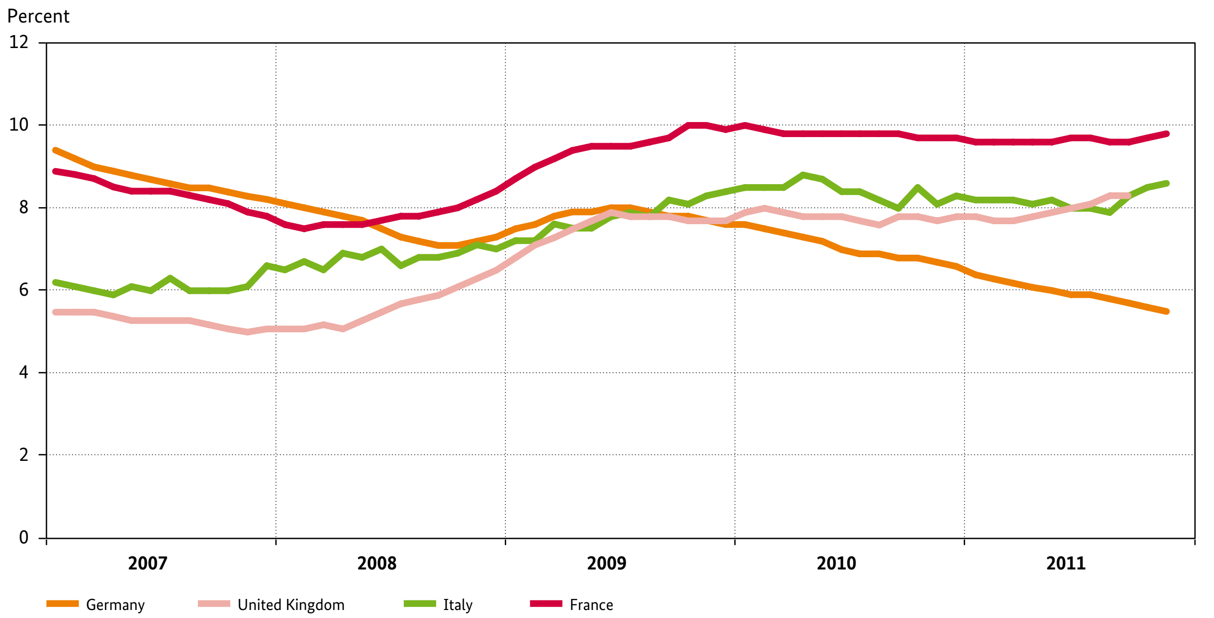
Consumer spending and incomes expanding

206. Consumer spending picked up substantially last year. Expressed as an annual average, consumer spending grew by 1.5 percent – the sharpest increase since 2006. The Federal Government expects consumer spending to continue to develop positively. The preconditions for this remain excellent. The labour market is robust, incomes are rising and the price climate is favourable. On top of this there is relief from the lower contribution rate to the statutory pension insurance system. Indicators like the propensity of consumers to purchase, as surveyed by the Consumer Research Institute (GfK), also suggest a generally positive development in consumer spending. The level of consumer confidence, as surveyed by the European Commission, also signals a high level of confidence on the part of German consumers in the European comparison (cf. Figure 19).

Actual gross wages and salaries earnings per person employed (effective wages) are expected to grow by 2.4 percent this year. In view of the continued rise in employment, the total rise in gross wages and salaries of 2.8 percent will again be 0.4 percentage points greater than the corresponding per-capita variable (gross wages and salaries per employee). It is true that the lower contribution rate to the statutory pension insurance system will boost the net wage, but the higher income tax due to the progressive tax tariff will counteract this. The 2.5 percent rise in net wages and salaries will consequently be somewhat lower than the corresponding figure for gross wages and salaries. At nearly 44 percent, these will account for the largest element of disposable income of private citizens.

Monetary welfare benefits will also contribute to an increase in disposable income. They account for roughly 24 percent of the disposable income of private citizens.

Figure 18: Unemployment rates in the European comparison (seasonally adjusted)



Source: OECD

The favourable development in gross wages and salaries last year will be reflected in the pension adjustment. Also, the number of pensioners will rise. Finally, the adjustments to the standard rates for the basic provision for job seekers and the allowance for those in higher education and training will boost incomes. Altogether, monetary welfare benefits for private citizens will rise appreciably in comparison with the preceding year.

Income from self-employment and property of private households will also contribute to the increase in disposable income this year. The development in profits of the self-employed is likely to point upwards despite the slow-down in overall economic growth. Income from assets will be reduced by the low interest rates; however, the payments of dividends could have an expansionary effect in view of the favourable corporate profit situation last year. Taken together, all of these factors are expected to boost the disposable income of individuals by 3.0 percent (cf. Figure 20).

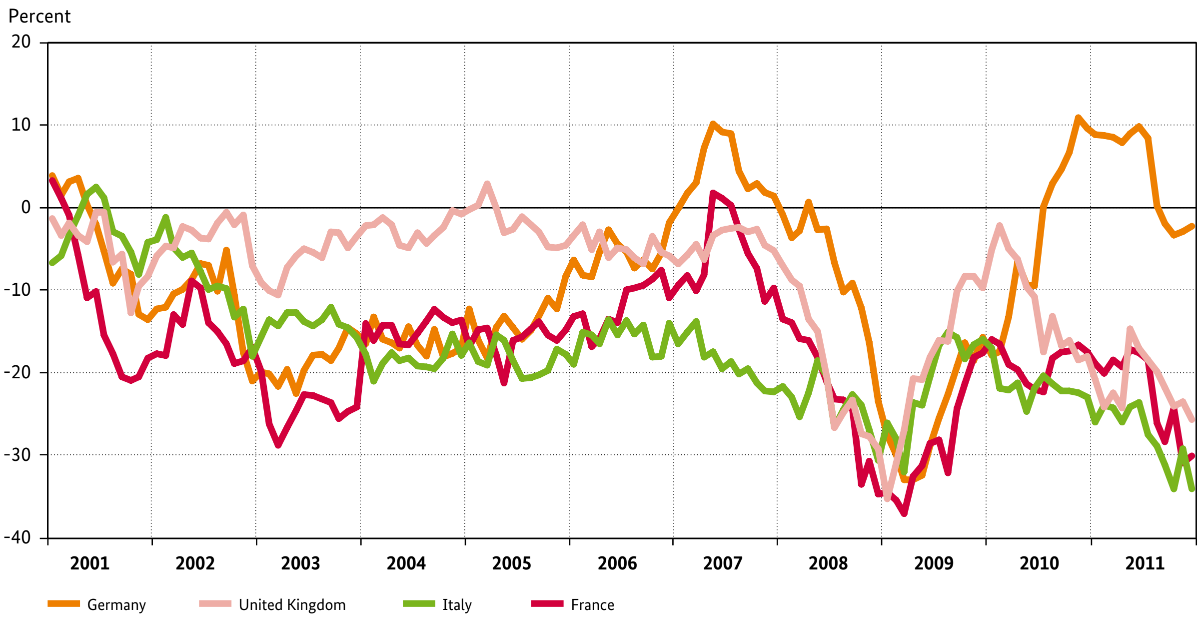
The Federal Government does not expect any tangible change in the savings rate this year. In view of the good income prospects and the robust labour market, the average propensity of individuals to save money will remain virtually unaltered. The development of disposable income will thus make possible a rise in consumer spending of 3.0 percent in current prices. The private consumption deflator is expected to increase by 1.7 percent, similar to the rate of increase in the consumer price index. Altogether, this will result in a solid increase of 1.2 percent in consumer spending in real terms. Compared with the average rise in consumer spending over the last decade of around 0.4 percent p.a., the growth in consumer spending will be above average for the second year in succession. It will thus be a major pillar of the domestic German economy.

Keeping to the path of budget consolidation

207. Government consumption this year will grow slightly more than last year, at a nominal 3.2 percent. It is true that employees' remuneration and intermediate consumption will record more moderate rises than last year. However, this restraint on expenditure will be more than offset by faster growth in welfare benefits in kind. In price-adjusted terms, government consumption is expected to grow by 1.0 percent.

208. In view of the favourable economic development and the budget consolidation, the overall public-sector financing balance improved clearly in 2011, to -1.0 per-

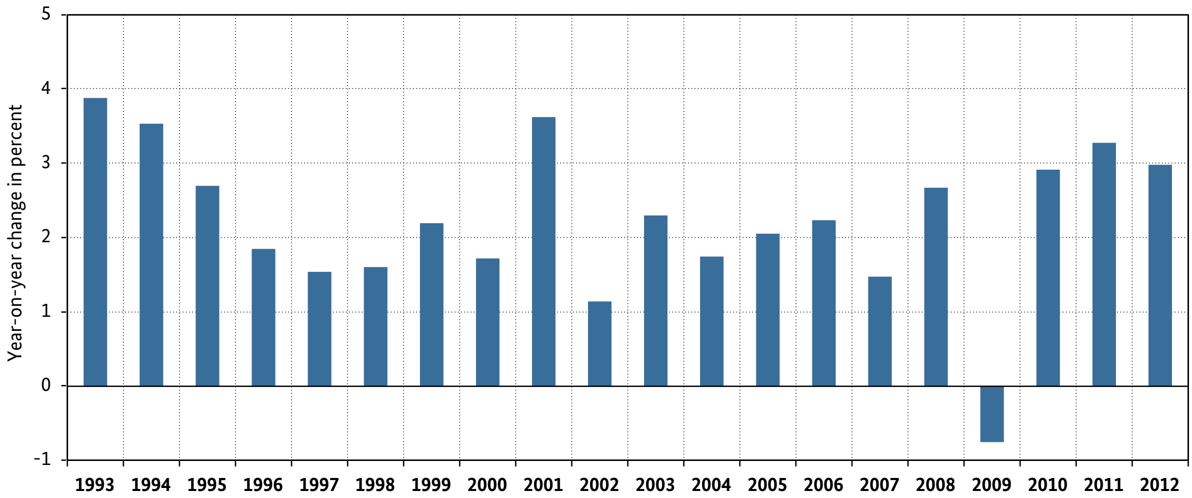
Figure 19: Consumer confidence in the European comparison



Source: European Commission

cent in relation to nominal gross domestic product. The deficit rate thus actually dropped below the Maastricht reference rate of 3 percent two years earlier than required by the deficit procedure. The deficit is likely to amount to roughly 1 percent this year again in terms of nominal gross domestic product.

Figure 20: Disposable income of private households



Source: Federal Statistical Office; own calculations

Box 12: Review of the Annual Projection 2011 and the Actual Development

The 2011 annual projection reflected a tone of cautious confidence. In last year's annual projection, the Federal Government expected the powerful global economic stimuli to gradually ease off and the domestic economy to increasingly drive growth in Germany. Also, the Federal Government assumed that the process of catching-up following the crisis would slow down whilst capacity utilisation rose. Overall, therefore, the upswing was expected to continue at a more moderate pace. Growth was expected to be appreciably higher than the eurozone average. Projecting a rise in gross domestic product of 2.3 percent (adjusted for price), the Federal Government was somewhat more cautious than the average forecast of 2.5 percent calculated from 30 separate forecasts by Consensus Economics. According to provisional annual figures from the Federal Statistical Office, economic output increased over the course of 2011 by 3.0 percent, or 0.7 percentage points more than expected in the 2011 annual projection.

As expected in the annual projection, foreign trade only made a small contribution to overall economic growth in 2011. In contrast, Germany's domestic market developed even more dynamically than originally expected. This encouraging development was primarily driven by the brisk investment activity, the continuing substantial growth in employment, and the rising incomes. This has made Germany more resilient to the difficulties in the international environment.

With surprisingly high growth of 1.3 percent in the first quarter against the previous quarter, Germany made a brilliant start in 2011. Even though this development was partly due to the effects of the weather and the related powerful expansion in the construction sector, it soon became clear that overall economic development in 2011 could be more positive than assumed in the annual projection (cf. Overview 7). The slow-down in the pace of growth which the 2011 annual projection assumed would occur in the course of the year did indeed take place (see Figure 15).

Once again, the labour market was the driving force for the dynamic domestic economy. Last year, employment reached a new record high. The rise in employment was even stronger than anticipated in the annual projection. The Federal Government originally assumed a rise in employment of 0.8 percent or 190,000 people. According to provisional figures from the Federal Statistical Office, employment expanded by 1.3 percent or 541,000 people in 2011. The high demand for labour resulted in an additional mobilisation of the hidden reserves. In particular against the background of the demographically induced decline in the working population, the sharp rise in employment, which resulted in a reduction in the previously unutilised employment potential, should be viewed especially positively. The drop in the unemployment rate to 7.1 percent occurred as expected at the beginning of the year.

The positive development on the labour market also meant that gross wages and salaries expanded more strongly overall than assumed a year ago. The background was – in addition to the rising number of employees – a powerful positive wage drift (difference between the development in effective wages and collectively agreed wages). The related clear improvement in purchasing power boosted growth in consumer spending, which increased by 1.5 percent over 2010 (adjusted for prices). As a result, last year saw the strongest rise in consumption of the last five years. Crude oil prices rose appreciably more sharply last year, at 111 US dollar per barrel of Brent crude, than had been expected in the technical assumption of 94 US dollar per barrel. The rise in the price level induced by this was higher than expected, and partly for this reason the original forecast of price-adjusted growth in consumption of 1.6 percent was not quite reached. Nominal consumption developed slightly more strongly than forecast.

Private-sector investment in housing also benefited from the positive development in income. The favourable factors like rising employment and incomes and low mortgage rates further stimulated investment in housebuilding. Overall, investment in construction increased by 5.4 percent. In the annual projection, the Federal Government had expected an increase of 1.7 percent. At 8.3 percent, investment in equipment rose somewhat more strongly than originally forecast (+8.0 percent).

The overall public-sector deficit was also far lower than expected at the beginning of 2011, at -1.0 percent in terms of nominal gross domestic product. In particular, a more dynamic development in tax revenues and the continuing improvement in the situation on the labour market resulted in a clear drop in the deficit rate. Further to this, lower tax refunds following a contentious court case on taxation ("Meilicke-ruling") substantially relieved the burden on the public-sector budgets.

Overview 7: Comparison of 2011 projection with the first provisional figures for the year[1]

Key figures for macroeconomic trends in Germany	Annual projection 2011	Actual outcomes 2011
	Year-on-year changes in percent	
Gross domestic product (GDP), output approach		
GDP (price-adjusted)	**2.3**	**3.0**
Employment (domestic)	0.8	1.3
GDP per person employed	1.5	1.6
GDP per hour worked	0.9	1.2
Unemployment rate in percent (according to national accounts)[2]	*6.0*	*5.7*
Unemployment rate in percent (as defined by the Federal Employment Agency)[2]	*7.0*	*7.1*
GDP, expenditure approach (in current prices)		
Consumption expenditures		
Private households and non-profit institutions	3.4	3.7
Government	1.9	2.7
Gross fixed capital formation	4.4	7.9
Changes in inventories etc. (in billion euro)	*-3.7*	*-8.3*
Domestic demand	3.3	4.1
Net foreign demand (in billion euro)	*129.0*	*133.5*
(in percent of GDP)	*5.0*	*5.2*
Gross domestic product (nominal)	**3.3**	**3.8**
GDP, expenditure approach (price-adjusted)		
Consumption expenditures		
Private households and non-profit institutions	1.6	1.5
Government	1.0	1.2
Gross fixed capital formation	4.3	6.5
Machinery and equipment	8.0	8.3
Construction	1.7	5.4
Other plant and equipment	4.8	4.8
Changes in inventories etc. (contribution to GDP growth rate)[3]	*0.0*	*-0.1*
Domestic demand	2.0	2.2
Exports	6.5	8.2
Imports	6.4	7.2
Net foreign demand (contribution to GDP growth rate)[3]	*0.4*	*0.8*
Gross domestic product (real)	**2.3**	**3.0**
Price trends (2000 = 100)		
Private consumption expenditures[4]	1.7	2.1
Domestic demand	1.3	1.8
Gross domestic product[5]	1.0	0.8
Distribution of gross national income (GNI)		
(resident concept)		
Wages and salaries	3.1	4.5
Entrepreneurial and property income	4.7	1.5
National income	3.6	3.5
Gross national income	3.3	3.5
Additional information (resident concept):		
Persons employed	0.8	1.3
Gross wages and salaries – total	2.9	4.8
– per employee	2.1	3.4
Household disposable income	3.4	3.3
Savings rate in percent[6]	*11.3*	*10.9*

1 Up to 2011, preliminary figures from the Federal Statistical Office as of 11 January 2012
2 Based on total number of persons employed;
3 Contribution to GDP growth rate;
4 Year-on-year change in the consumer price index: 2010: 1.1 percent; 2011: 2.3 percent;
5 Year-on-year change in unit labour costs: 2010: -1.2 percent; 2011: 1.5 percent;
6 Savings as a percentage of household disposable income including pension fund reserves.