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Assessment of the 2013 national reform programme and stability programme for GERMANY

Accompanying the document

Recommendation for a COUNCIL RECOMMENDATION

on Germany's 2013 national reform programme and delivering a Council Opinion on Germany's stability programme for 2012-2017

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The German economy is expected to continue growing in the coming years. According to the Commission's 2013 spring forecast, annual real GDP growth is projected to decelerate further from 0.7 % in 2012 to 0.4 % in 2013, before picking up to 1.8 % in 2014. Domestic demand is expected to be the main driver of economic growth. The unemployment rate should continue to decline, though only slightly, from 5.5 % in 2012 to 5.4 % in 2013 and 5.3 % in 2014. Growth in compensation per employee is expected to rise from 2.4 % in 2013 to 3.1 % in 2014, while annual headline inflation is forecast to decline from 2.1 % in 2012 to 1.8 % in 2013 and 1.6 % in 2014. The current account surplus is expected to decline but to remain above 6 % of GDP over the forecast horizon.

Germany recorded a headline budget surplus of 0.2 % of GDP in 2012. The Commission predicts this will turn into a deficit of 0.2 % of GDP in 2013, while the budget is expected to come into balance in 2014. In structural terms, Germany registered a surplus of 0.3 % of GDP in 2012, reaching its medium-term budgetary objective, and the Commission forecasts it will remain in surplus of around ½ % of GDP in 2013 and 2014. Germany's debt-to-GDP ratio increased to 81.9 % in 2012, mainly due to the euro area stabilisation measures, and is forecast to fall to 81.1 % in 2013 and 78.6 % in 2014.

Key Issues

Germany has made limited progress in taking measures to address the 2012 CSRs. Germany's public finances have continued to improve and the budget produced a small surplus in 2012. Financial sector regulation and supervision has been strengthened, but there is still scope to increase the efficiency of the banking sector. Germany is making efforts to accelerate the deployment of energy networks, but initiatives to reduce the overall costs of transforming the energy system have not yet led to tangible results. In other areas, reform efforts have been limited, e.g. as regards improving incentives to work. Efforts to stimulate competition in the services and railway sectors have been limited.

Despite the current overall favourable economic situation, Germany faces important challenges, especially in the medium and long term, but its policy plans for 2013 do not go far enough in some areas to address these. In particular, Germany needs to tackle shortcomings in the labour market and in the energy system, inefficiencies in some spending policies and in the tax system, and barriers to competition, particularly in the services, railway and banking sectors. The country would also benefit from more balanced growth based on strengthened domestic demand.

- **Public finances**: Germany's public finances have continued to improve thanks to its good economic and labour market performance, but at about 82 % of GDP in 2012, government debt is still well above the 60 % of GDP threshold of the Stability and Growth Pact. There is scope to improve the efficiency of the health and long-term care systems. The application of a reduced VAT rate to a wide range of goods and services and the outdated valuation of the real estate tax base create inefficiencies in the tax system.

- **Labour market and education:** A shrinking workforce is expected to affect Germany's potential growth. Shortages of skilled workers are already emerging in various sectors and regions. At the same time, there is scope for increasing the labour force participation and the number of hours worked among certain people, including women, low-wage earners, people with a migration background and long-term unemployed. Moreover, the skills potential in particular of those with a socio-economically disadvantaged background is not fully used.

- **Energy**: The new energy strategy ('energy turnaround') opens the door to new growth opportunities and helps reduce Germany's dependence on external energy sources in the long term, but it also involves challenges in terms of potentially high economic cost, the possibility of capacity constraints, and the need for enhanced coordination with neighbouring countries.

- **Competition, innovation and regulatory framework**: Barriers to competition persist in the services, railway and banking sectors. Germany is one of the EU's innovation leaders, but other economies are investing more in research and innovation. There is also room for improvement and simplification in business regulation.

- **Current account:** Germany has recorded significant current account surpluses over the last decade. Reducing the surplus would — to the extent that it relates to market failures and structural reform needs — benefit Germany and at the same time contribute to the euro area rebalancing process by creating positive spillovers.

1. INTRODUCTION

In May 2012, the Commission proposed a set of country-specific recommendations (CSRs) for economic and structural reform policies. On the basis of these recommendations the Council of the European Union adopted four CSRs in the form of a Council Recommendation in July 2012.[1] These CSRs concerned public finances, the financial sector, the labour market and the education system, and services and network industries. This Staff Working Document (SWD) assesses the state of implementation of these recommendations.

The SWD assesses policy measures in light of the findings of the Commission's Annual Growth Survey 2013 (AGS)[2] and the second annual Alert Mechanism Report (AMR),[3] which were published in November 2012. The AGS sets out the Commission's proposals for building the necessary common understanding about the priorities for action at national and EU level in 2013. It identifies five priorities to guide Member States to renewed growth: pursuing differentiated, growth-friendly fiscal consolidation; restoring normal lending to the economy; promoting growth and competitiveness for today and tomorrow; tackling unemployment and the social consequences of the crisis; and modernising public administration. The AMR serves as an initial screening device to determine whether macroeconomic imbalances exist or risks are emerging in Member States. The AMR found positive signs that macroeconomic imbalances in Europe are being corrected. To ensure that a complete and durable rebalancing is achieved, 14 Member States were selected for a review of developments in the accumulation and unwinding of imbalances.[4]

Against the background of the 2012 Council Recommendations, the AGS and the AMR, Germany presented updates of her national reform programme (NRP) on 12 April 2013 and of her stability programme on 17 April 2013. These programmes provide detailed information on the country's progress since July 2012 and on the future plans of the government. The information contained in these programmes provides the basis for the assessment made in this SWD.

The programmes submitted went through a consultation process involving the federal parliament, the federal council, regional authorities and stakeholders.

Overall assessment

The analysis in this SWD leads to the conclusion that Germany has made limited progress in taking measures to address the CSRs in the Council Recommendation. Germany's public finances have continued to improve and the general government budget produced a small surplus in 2012. The regulatory framework in the financial sector has been strengthened, but there still appears to be scope for increasing the efficiency of the banking sector. Germany is making efforts to accelerate the deployment of energy networks, but initiatives to minimise the overall economic costs of transforming the energy system have not yet led to tangible results. No substantial measures have been adopted to increase work incentives for second and low-wage earners. Progress in increasing the availability of full-time childcare facilities

1 OJ C 219, 24.7.2012, p. 35-37.
2 COM(2012) 750 final.
3 COM(2012) 751 final.
4 Germany was not selected for an in-depth review. 13 in-depth reviews were published on 10 April 2013. While selected for an in-depth review in the AMR, Cyprus was ultimately not reviewed under the Macroeconomic Imbalance Procedure in view of the advanced preparations for a financial assistance programme.

appears insufficient to meet the estimated needs and remains limited regarding the availability of all-day schools, while the new childcare allowance (*Betreuungsgeld*) may create an additional disincentive for parents to work. Some progress has been made to increase the performance of the education system. Efforts to stimulate competition in the services and railway sectors have been limited.

Overall, the policy plans submitted by Germany are relevant and in line with the AGS priorities, but in some areas they do not go far enough to address key challenges. The NRP and the stability programme are broadly coherent. Both documents confirm Germany's commitment to continue sound fiscal policies. The NRP reiterates plans to review the system to promote renewable energy and announces measures to further improve the stability of the financial sector. Germany's plans appear unambitious when it comes to improving the efficiency of public expenditure and the tax system, activating labour and skills potential and increasing competition in the services and railway sectors. The NRP does not provide estimates of the quantitative impact on growth of specific reform measures.

2. ECONOMIC DEVELOPMENTS AND CHALLENGES

2.1. Recent economic developments and outlook

Recent economic developments

In 2012 and early 2013, economic growth in Germany was significantly affected by the slowdown in global economic activity and the prevailing uncertainty caused by the debt crisis. After a weakening of growth in the second and third quarters of 2012, GDP dropped abruptly by 0.7% q-o-q (seasonally and working-day adjusted) in the final quarter. This setback was temporary and some stabilisation took place in the first quarter of this year. In annual terms, real GDP growth decelerated to 0.7% in 2012 following a strong recovery and expansion in 2010 and 2011.

After having been the main growth driver in the two previous years, domestic demand weakened in 2012, which contributed to an increased current account surplus. The increase in consumption was not sufficient to offset the marked decrease in gross investment. This led import growth to slow down more strongly than export growth, resulting in a considerable contribution of net exports to real GDP growth. This development was reflected in a strong increase in the current account surplus in 2012, although other factors including safe-haven effects with regard to primary income might have played a role as well. While the surplus vis-à-vis the rest of the world increased significantly, the surplus vis-à-vis the euro area continued to decline, mainly due to import growth exceeding weak export growth with respect to the euro area. Moreover, in particular the balance of primary income and the services balance were subject to major upward revisions for the past few years. According to balance of payments statistics, the current account balance has been above 6% of GDP since 2010 and reached 7.0% in 2012.

The labour market continued to perform favourably in 2012 and employment growth turned out to be remarkably robust considering the weakened economic activity. Despite a deceleration, employment rose strongly by 1.1% and the unemployment rate declined to an average of 5.5%, putting it at the lowest level since 1991. This was accompanied by a significant increase in gross wages and salaries per employee of 2.7%. These labour market developments, together with firms' strong international competitiveness and favourable financing conditions, underpin the German economy's still intact fundamentals. Headline inflation declined but remained slightly above the 2 % threshold, in particular owing to energy and food price increases.

Economic outlook

According to the Commission's 2013 spring forecast, economic growth is projected to reaccelerate along with the expected improvement to the external environment. Equipment investment is forecast to start recovering in the course of the year, so that import growth is likely to increase more strongly than export growth from then on. Moreover, low interest rates, rising wages and robust labour market developments should continue to underpin private housing investment and consumption. Overall, real GDP is projected to increase by 0.4 % in 2013 and by 1.8 % in 2014.

The expansion of employment is expected to slow down given that hours worked per employee are likely to be gradually restored. Employment is forecast to expand by 0.5 % this year and next. Labour supply is expected to be boosted further by considerable net migration, besides the sustained upward trend in labour market participation. As a result, the unemployment rate should continue to decline — though only slightly — reaching 5.4 % this year and 5.3 % next year. With stronger wage growth and no further changes in the pension contribution rate, growth in compensation per employee is expected to accelerate from 2.4 % in 2013 to 3.1 % in 2014. The gradually increasing scope for passing on higher labour costs to consumer prices is expected to be more than offset by lower pressure from energy and food prices in particular. Overall, annual headline inflation is forecast to continue to decline to 1.8 % in 2013 and 1.6 % in 2014.

The current-account surplus is expected to decline but to remain above 6 % of GDP over the forecast horizon. Based on the projected growth pattern with investments boosting imports and further real wage increases fostering consumption, domestic demand is expected to strengthen and net exports to contribute less to GDP growth over the forecast horizon. Returning confidence in foreign financial assets, along with dissipating uncertainty, should also contribute to reducing the current account surplus.

Commission estimates indicate that potential output will grow at around 1¼ % p.a. in 2013/2014, followed by a gradual decline to around 1 % in 2015-2017. The negative output gap, arising from potential growth exceeding GDP growth in 2013, is expected to be partly closed in 2014.

The NRP and the stability programme share the same macroeconomic outlook, which is broadly in line with the Commission's 2013 spring forecast as regards the pace and pattern of economic growth in 2013 and 2014, as well as with the Commission's estimate of Germany's medium-term potential growth rate. Labour-market developments as projected by the government appear somewhat pessimistic, while the programme's estimate of potential growth is somewhat higher in 2015-2017 than the Commission's estimates.[5] The NRP and the stability programme do not provide estimates of the quantitative impact on economic growth of specific reform measures and do not specify whether their impact is explicitly considered in its macroeconomic outlook.

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[5] The outlook underlying the programmes is based on the government's January 2013 Economic Projections. Labour market and potential growth projections published after the submission of the programmes are more closely in line with the Commission's estimate.

2.2. Challenges

Despite the current overall favourable economic situation, Germany faces important challenges, especially in the medium and long term. In particular, the expected significant decline in the workforce due to demographic change and the potential risks associated with the deep transformation of the energy system could hinder Germany's economic performance in the future. This means that obstacles to increasing potential growth — including shortcomings in the labour market and in the energy system, inefficiencies in some spending policies and in the tax system, as well as barriers to competition in some sectors — need to be addressed. The country would also benefit from more balanced growth based on strengthened domestic demand. These challenges were already identified in the 2012 SWD and reflected in the 2012 CSRs.

Most important of all, though, is the need to increase the labour supply and enhance human capital in view of the demographic changes ahead. A shrinking workforce is expected to affect Germany's potential growth.[6] Shortages of skilled workers are already emerging in various sectors and regions, affecting in particular small and medium-sized enterprises. Demographic change may also weaken entrepreneurial activity in the future by preventing the creation of new businesses. At the same time, there remains scope for increasing the labour force participation or the number of hours worked among certain people, including women — who represent the largest potential source of additional labour force participation according to the 2011 Plan to Secure Skilled Labour (*Fachkräftesicherung*) — low-wage earners, people with a migration background, older workers and long-term unemployed. Moreover, the skills potential of some people, in particular those with a socio-economically disadvantaged background, is not fully used. Improving the performance of the education system and the integration of people into the labour market would also contribute to reducing the high gender pay gap and the risk of poverty and social exclusion for persons of all ages, including the elderly.

The deep transformation of Germany's energy system remains a challenge. The new energy strategy ('energy turnaround') opens the door to new growth opportunities and helps reduce the country's dependence on external energy sources in the long term. However, this strategy also involves challenges in terms of potentially high economic costs accentuated by inefficiencies in the energy policy instruments, the possibility of capacity constraints caused by delays in the deployment of infrastructure, and the need for enhanced coordination with neighbouring countries to avoid negative spill-over effects.

There are still inefficiencies in some spending policies and in the tax system. Germany's public finances have continued to improve thanks to its good economic and labour market performance. However, at about 82% in 2012, government debt as a percentage of GDP is still well above the 60% threshold of the Stability and Growth Pact. There is scope for improving the efficiency of the health and long-term care systems. The application of the reduced VAT rate to a wide range of goods and services and the outdated valuation of the real estate tax base create inefficiencies in the tax system.

Barriers to competition persist in the services sectors, including in regulated professions, as well as in the railway and banking sectors, and there is still room for improvement as regards R&D intensity, innovation and the regulatory framework. Productivity growth in

[6] The Federal Statistical Office estimates that the German population of working age will decline by 18-22% by 2035 and by 27-34% by 2060 compared with 2008, depending on the assumptions made about migration. There are important differences between *Länder*.

the services sector is low and there is scope for increasing competition in the services sectors, e.g. by eliminating unnecessary restrictions in professional services and certain crafts, and for improving the institutional framework for competition. Competition in the railway markets remains weak. The financial sector has undergone significant adjustment and the regulatory framework has been strengthened. However, there still appear to be obstacles to market-driven consolidation in the banking sector which affect the overall efficiency of the financial sector. Germany is one of the EU's innovation leaders, but other economies are investing more in research and innovation, and bottlenecks for start-up companies are hindering the development of high-tech sectors. The business-friendliness of the regulatory environment is generally good, although there is room for improvement and simplification in certain areas, in particular those affecting small and medium-sized enterprises.

Germany has recorded significant current account surpluses over the last decade. This needs to be seen against the background of sizeable domestic economic imbalances that built up in the wake of reunification and the following adjustment process. In particular, wage moderation and labour market reforms took a toll on private consumption, while domestic investments suffered from a protracted reduction of excess capacity in the construction sector. However, reducing the surplus would — to the extent that it relates to market failures and structural reform needs — benefit Germany and at the same time contribute to the euro area rebalancing process by creating positive spillovers. Activating untapped labour and skill potential as well as increasing competition particularly in non-tradable sectors in line with the 2012 CSRs could help raise income, reallocate resources and promote investment, thus contributing to diversifying growth by strengthening domestic demand.

3. ASSESSMENT OF POLICY AGENDA

3.1. Fiscal policy and taxation

Budgetary developments and debt dynamics

Germany's 2013 stability programme aims at achieving the medium-term budgetary objective (MTO) and steadily bringing down the debt-to-GDP ratio over the programme period. The stability programme confirms the MTO of a structural deficit no higher than 0.5 % of GDP, which is in line with the requirements of the Stability and Growth Pact. A slight structural surplus is expected in 2013, which is planned to stabilise at roughly ½ % of GDP in the coming years.

Germany recorded a general government budget surplus of 0.2 % of GDP in 2012 and therefore achieved a budgetary position significantly above its deficit target of 1 % of GDP set in last year's stability programme. Even though growth turned out as expected, the increase in revenues was stronger and the expenditure growth lower than initially planned. Last year's budget projections have been retained with an expected deficit of ½ % of GDP in 2013 and a balanced budget in 2014, which is broadly in line with the Commission's spring 2013 forecast of a deficit of 0.2 % of GDP for 2013 and a balanced budget for 2014 (see Table III in the annex). All levels of government are expected to register balanced budgets or even small surpluses as from 2014.

The planned improvement in the government budget balance is driven by a decreasing expenditure-to-GDP ratio in combination with a stable revenue ratio. Below-average growth in employee compensation, social transfers other than in kind, gross fixed capital formation (following above-average investment in previous years due to stimulus packages) and interest expenditure is projected to more than offset above-average growth in social transfers in kind, in particular in the areas of health care and long-term care. The stability programme factors in the reduction in the pension contribution rate in 2013 as well as the increase in the minimum income tax allowance (see Box 1). No significant one-off measures are foreseen during the programme period. Overall, the budgetary targets appear realistic.

Box 1. Main measures

The favourable budgetary development and the positive trends in wages and employment have led the federal government to reduce taxes, social insurance contributions and fees. Overall, this is expected to provide businesses and citizens with cost cuts of nearly EUR 8 billion. In February 2013, a new law aimed at reducing fiscal drag took effect, which increases the basic income tax allowance from EUR 8004 to EUR 8130 in 2013 and EUR 8354 in 2014, with a view to bringing it into line with the rise in minimum subsistence income, and stipulates regular biannual reporting on fiscal drag. The pension contribution rate has been reduced by 0.7 pps to 18.9 % in 2013, following a reduction by 0.3 pps in 2012, which more than offsets the increase in the long-term care contribution rate by 0.1 pps. This reduction results from applying a semi-automatic rule and reflects the pension insurance scheme's currently favourable financial situation. Moreover, the quarterly EUR 10 fee paid by patients for medical treatment (*Praxisgebühr*) was abolished at the beginning of this year. Measures with a limited budgetary impact include investing more in federal transport infrastructure as well as simplifying business taxation and the taxation of travel expenses.

Main budgetary measures

Revenue	Expenditure
2013	
• Reduction in the pension contribution rate (-0.2 % of GDP) • Abolition of the quarterly fee for medical treatment (-0.1 % of GDP)	• n.a.
2014	
• Increase in the basic income tax allowance (-0.1 % of GDP)	• n.a.

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

Germany registered a structural surplus of 0.3 % of GDP in 2012 and thus achieved its MTO in line with last year's CSR. According to the stability programme, the (recalculated) structural surplus[7] will stay at 0.3 % of GDP in 2013 and improve to 0.7 % of GDP in 2014, which is broadly in line with the Commission's forecast of a structural surplus of 0.4 % of GDP in 2013 and 0.3 % of GDP in 2014. The structural balance is planned to remain positive in the following years. Hence, Germany plans to achieve its MTO throughout the programme

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

period. Germany complied with the expenditure benchmark in 2012. According to the information provided in the stability programme, the growth rate of government expenditure, net of discretionary revenue measures, will exceed the reference medium-term rate of potential GDP growth in 2013 (1.16 %). However, the expenditure benchmark is not binding given that it is intended to underpin the necessary adjustment towards the MTO (which Germany plans to continue to comply with). Moreover, the programme foresees that the growth rate of government expenditure will again be below the reference rate in 2014 (1.08 % of GDP).

The debt-to-GDP ratio increased by 1.5 percentage points (pps) to 81.9 % in 2012, mainly due to the euro area stabilisation measures, and is planned to fall throughout the programme period thanks to the denominator effect of GDP growth and the winding up of 'bad banks'. This is broadly in line with the Commission's forecast of a debt-to-GDP ratio of 81.1 % in 2013 and 78.6 % in 2014, which does not take into account potential gains from the winding up of 'bad banks' (see Table IV in the annex). Government debt is above the 60 % of GDP threshold of the Stability and Growth Pact and, following the correction of the excessive deficit in 2011, Germany is in a transition period under the debt reduction benchmark. In 2012, Germany made sufficient progress towards compliance with the debt reduction benchmark at the end of the transition period. Given that compliance with the MTO also ensures compliance with the debt reduction benchmark, both the stability programme and the Commission forecast indicate that Germany will make sufficient progress towards compliance with the debt criterion in the years to come.

Long-term sustainability

Germany does not appear to face any short-term, medium-term or long-term sustainability challenges. The medium-term sustainability gap[8], showing the adjustment effort up to 2020 required to bring debt ratios to 60 % of GDP in 2030, is at 0.3 % of GDP, significantly below the EU average of 2.2 % of GDP. This reflects a relatively strong initial structural budgetary position, while the ageing costs[9] are higher than the EU average. The long-term sustainability gap[10] shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, conditional upon achieving the relatively high structural primary surplus forecasted for 2014 and maintaining it afterwards. For Germany, this gap is at 1.4 % of GDP, which is much lower than the EU average (3 %). Also in the long-term, the relatively strong initial budgetary position contributes to offsetting the long-term age-related expenditure trends. The sustainability gaps would be higher if the structural primary surplus of 2.6 % of GDP in 2014 were to revert to the lower values observed in the past, such as the average for the period 1998–2012 of 1 % of GDP. As far as fiscal sustainability is concerned, the focus should, therefore, be on reducing government debt.

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8 See Table V. The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady improvement in the structural primary balance to be introduced until 2020, and then sustained for a decade, to bring debt ratios back to 60 % of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population.

9 Ageing costs comprise long-term projections of public age-related expenditure on pension, health care, long-term care, education and unemployment benefits. See the 2012 Ageing Report for details.

10 See Table V. The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the 60 % of GDP threshold of the Stability and Growth Pact.

Moreover, containing further age-related expenditure growth would contribute to the sustainability of public finances in the long term.

In line with the AGS and last year's recommendation to pursue its growth-friendly consolidation course, Germany has increased expenditure on education and research and would benefit from further efforts in this respect. Public and private expenditure on education and research reached 9.5 % of GDP in 2010[11] and appears to be well on track to achieve the national target of 10 % of GDP by 2015. Federal and *Länder* governments should ensure that the target will be met, despite the consolidation needs resulting from the application of the debt brake. Even more ambitious follow-up targets may be needed to catch up with the most innovative economies.[12] Attention should also be paid to enhancing the efficiency of government spending in these areas, especially by improving outcomes in the education system (see Section 3.3), and helping start-up companies to gain access to venture capital (Section 3.4).

In contrast, Germany has made only limited efforts to improve the efficiency of public spending on healthcare and long-term care. At 8.6 % of GDP in 2010,[13] the rate of public spending on healthcare in Germany is one of the highest in the EU and is likely to increase further due to demographic change and innovations in medical technology; this could potentially put a strain on public finances or result in an increasing contribution rate. The reduction in pharmaceutical expenditure in 2011 resulted mainly from temporary *ad hoc* rebates. In addition, the obligation to assess the added value of pharmaceuticals as the basis for price setting, introduced by the 2011 health reform, is expected to have a positive effect on expenditure growth in the future.[14] The quarterly fee paid by patients for medical treatment (*Praxisgebühr*) was abolished at the beginning of 2013 on the grounds that it was ineffective and created red tape (see Box 1). Alternative means could have been considered to promote the more efficient use of medical services. The efficiency of health care could be improved by i) enhancing competition on the insurance market, while avoiding selection by morbidity risks and ensuring appropriate health services across the country, ii) stimulating competition in health service provision and in pharmaceutical distribution, iii) better integrating inpatient, outpatient and rehabilitation care and iv) ensuring that care delivery and reimbursement systems are focused more on the needs of patients and less on the supply of services.[15] The reform of long-term care, which took effect this year and includes an extension of benefits to dementia patients, an increase in the contribution rate of 0.1 pps, and fiscal incentives for voluntary private insurance, is unlikely to be sufficient to cover future cost increases.

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11 The 9.5 % share of GDP was made up of 7 % on education and 2.8 % on research and development, less the amount spent on research and development at universities (which is included in education expenditure) (Statistisches Bundesamt (2012), *Bildungsfinanzbericht 2012*).

12 The expert commission on research and innovation appointed by the federal government recommends increasing the expenditure targets to 8 % of GDP for education and 3.5 % for research and development by 2020 (Expertenkommission Forschung und Innovation (2013), *Gutachten zu Forschung, Innovation und Technologischer Leistungsfähigkeit Deutschlands*).

13 Eurostat database.

14 Henschke, C., L. Sundmacher and R. Busse (2013), *Structural changes in the German pharmaceutical market: Price setting mechanisms based on the early benefit evaluation*, Health Policy, Vol. 109: 263-269.

15 Sachverständigenrat (2012), *Stabile Architektur für Europa — Handlungsbedarf im Inland*, Jahresgutachten 2012/13; Augurzky, B., S. Krolop, R. Gülker, C. Hentschker and C. M. Schmidt (2012), *Krankenhaus Rating Report 2012: Krankenhausversorgung am Wendepunkt?*, Medhochzwei Verlag; Porter, M. E., C. Guth (2012), *Redefining German Health Care: Moving to a Value-Based System*, Springer Berlin Heidelberg; European Commission and the Economic Policy Committee (2010), *Joint report on health systems*, European Economy Occasional Papers 74/2010.

Fiscal framework

There has been some progress in the implementation of the constitutional balanced-budget rule ('debt brake') since last year's CSR, although most *Länder* have not laid down implementing rules. The debt brake stipulates that both the federation and the *Länder* should have structurally balanced budgets from 2016 and 2020, respectively. However, more specific legal provisions appear to be required to ensure an effective application of the debt brake in the annual budgetary procedure. Such detailed provisions for the federal budget have been laid down in the federal constitution and in implementing rules. This has not been done to the same extent at *Länder* level, which is the sole responsibility of the *Länder* themselves. So far, six *Länder* have enshrined reinforced balanced budget rules in their constitutions and five *Länder* in their budget laws.[16] Only Rhineland-Palatinate, Lower Saxony and Schleswig-Holstein have laid down implementing rules. Lower Saxony and Schleswig-Holstein have defined decreasing annual borrowing ceilings for the transition period until 2020. Rhineland-Palatinate and Schleswig-Holstein have specified provisions for preventing recourse to financial transactions, correcting the deficit for the impact of the business cycle, applying exemption clauses for natural disasters and other emergencies, and using a control account that records deviations in budget execution from the authorised level of borrowing as debits or credits, which reduce or increase the permitted level of net borrowing in the following year.

Moreover, in 2012 the federal government adopted a draft law aimed at transposing the Treaty on Stability, Coordination and Governance. Accordingly, it sets the ceiling for the general government structural deficit at Germany's MTO of 0.5 % of GDP as defined in the Stability and Growth Pact, while the *Länder* are made responsible for their municipalities. Compliance with the national deficit ceiling will be monitored by the existing Stability Council, which consists of the federal and *Länder* ministers of finance and the federal minister of economics. It will be supported by an independent advisory board that publishes statements on compliance with the deficit ceiling and recommendations for corrective action in the event of non-compliance.[17] The draft law also covers the sanctions that may be imposed on the federal government and the *Länder* under the reformed preventive arm of the Stability and Growth Pact.

In view of considerable consolidation needs in several *Länder*,[18] the application of the debt brake and the Treaty on Stability, Coordination and Governance would be made more effective if fiscal relations between the different layers of government were more efficient. In particular, budget consolidation could be facilitated by exploring ways to enhance fiscal responsibility and accountability; this could be done by disentangling shared tax revenues and by reducing disincentives to improve revenues for both contributor and beneficiary *Länder* in the horizontal fiscal equalisation system. The expiry in 2019 of the current provisions for the fiscal equalisation system as well as of the special transfers from the

16 Hamburg, Hessen, Lower Saxony, Mecklenburg-Western Pomerania, Rhineland-Palatinate and Schleswig-Holstein have enshrined debt brakes in their respective constitutions and Baden-Württemberg, Bavaria, Saxony, Saxony-Anhalt and Thuringia in their budget laws. Berlin, Brandenburg, Bremen, North Rhine-Westphalia and Saarland have not enshrined reinforced balanced budget rules in *Länder* legislation.

17 The advisory board will consist of one representative each from the *Bundesbank*, the Council of Economic Experts (*Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung*), and the institutes that prepare the joint economic forecast, as well as experts appointed by the federal and *Länder* governments, the associations of local authorities and the social security institutions.

18 The Sachverständigenrat (2011, *Verantwortung für Europa wahrnehmen*, Jahresgutachten 2011/12) estimates the consolidation needs across all *Länder* until 2020, as a weighted average compared to the base years 2007 to 2010, at 9 % of current primary expenditure. Consolidation needs range from zero in Bavaria to more than 20 % in Saarland, Bremen and Berlin.

federal budget to the eastern *Länder* under the Solidarity Pact II may therefore give rise to a comprehensive review of fiscal relations.

Tax system

Germany has made limited progress in addressing the inefficiencies in the tax system identified in the 2012 SWD. In line with the priorities of the AGS, the country could benefit from reducing the tax burden on labour, notably for low-wage and second earners, narrowing the use of the reduced value-added tax (VAT) rate, increasing revenues from recurrent property taxes, lowering tax expenditures, in particular those with environmentally harmful effects, and further reducing the corporate tax bias towards debt-financing.

Limited efforts have been made as regards the recommendation to reduce the high tax wedge in a budget-neutral way, in particular for low-wage earners. The high tax burden on labour discourages some people from participating in the labour market or increasing the number of hours they work.[19] The tax wedge for workers earning 50% and 67% of the average wage is among the highest in the EU (single person without children, data for 2012).[20] Inactivity and unemployment traps are also relatively high. Germany has adopted a law aimed at reducing fiscal drag, which implies a slight increase in the basic income tax allowance (see Box 1). However, the law falls short of the initial proposal to also adjust the tax scale and to introduce a biannual review to limit unintended across-the-board tax increases due to inflation, as is already in place in many Member States. The reduction in the pension contribution rate also contributes to a lower tax burden on labour. However, this reduction results from applying a semi-automatic rule rather than to structural adjustments (see Box 1). Health insurers are expected to cover cost increases by flat-rate contributions combined with compensation for low-income earners through the tax system, which would lower the impact on labour costs. However, this has not been necessary so far due to the favourable financial situation of the health fund. Overall, the burden of social contributions remains below the federal government's target of 40% of gross wages and salaries.

Germany has not taken action in response to last year's recommendation to phase out the significant fiscal disincentives for second earners. Second earners still face significant fiscal disincentives due to the joint taxation of income for married couples (*Ehegattensplitting*) and the free health-insurance coverage for non-working spouses, as pointed out in the 2012 SWD.[21] Together with other factors, fiscal disincentives discourage women in particular from participating in the labour market or increasing the number of hours they work. The NRP does not announce any measure in this regard. The evaluation of taxation and social benefits related to marriage and family announced in the 2012 NRP might provide valuable information for reforms aimed at increasing the effectiveness and efficiency of family policy in the coming years.

A reduction in the tax burden on labour could be paid for by tapping more growth-friendly revenue sources. The application of the reduced VAT rate (currently 7%) to what is now quite a wide range of goods and services could be narrowed and VAT administration

[19] The fact that labour taxes and social contributions account for a relatively high proportion of total revenues could also result in a smaller revenue base in the longer term, because of the shrinking active labour force.

[20] Commission estimate based on OECD tax and benefits model.

[21] The high share of women among mini-job workers is also related to the joint income taxation system. While income below the mini-job threshold of EUR 400 per month (EUR 450 as of 2013) is exempted from income tax, if the income is above that threshold, the full income is subject to the (joint) income tax. Bundesministerium für Familie, Senioren, Frauen und Jugend (2012), *Frauen im Minijob.*

reviewed in an effort to increase efficiency, improve tax collection and fight fraud.[22] Reassessing the tax base of the municipal recurrent real estate tax (*Grundsteuer*), which dates back to market values of 1963/64 or even before, would contribute to improving the fairness in the distribution of the tax burden and to increasing the particularly low revenues from recurrent property taxes (0.5 % of GDP in 2011 vs 1.3 % in the EU-27). Moreover, there is still scope for reducing inefficient tax expenditures, especially those with environmentally harmful effects such as energy tax reductions and exemptions, the favourable taxation of company cars or the commuter income tax deduction. Energy and electricity tax reductions for energy-intensive businesses have been extended beyond 2012 on condition that the beneficiaries introduce energy audit systems and the sectors concerned achieve predefined energy efficiency targets. It should be a priority to limit those reductions to a minimum.

Conditions for investment in Germany could be further improved by reducing the corporate tax bias towards debt-financing and reforming the local trade tax (*Gewerbesteuer*). Despite the 'interest barrier' (*Zinsschranke*) limiting the deductibility of net interest expenses (on all kinds of debt financing), there remains a corporate tax bias towards debt-financing. Inefficiencies arise from the trade tax due to the inclusion of non-profit elements in the tax base.

3.2. Financial sector

The German financial sector has undergone significant adjustment since the outbreak of the financial and sovereign debt crisis and has become more resilient. Between spring 2008 and the third quarter of 2012, the twelve major German banks increased their 'core tier 1 capital' from 8.3 % to 13.6 % of the risk-weighted assets.[23] The loan-to-deposit ratio is below the euro area average, while a low ratio of non-performing loans indicates solid bank assets. The level of private sector indebtedness is below the euro-area average and appears moderate. Businesses (including small and medium sized enterprises) still have very good access to finance and there are no indications of significant tightening of lending conditions,[24] although access to venture capital remains underdeveloped (see Section 3.4). Lending conditions also remain very favourable for private households, even though credit standards for housing loans have recently been tightened somewhat. In addition to stricter capital requirements, German banks face increased competition in domestic markets and a growing number of businesses are having recourse to capital markets without bank intermediation. Low interest rates may also pose a challenge for institutional investors, notably insurance companies.

Since last year's CSR to address the remaining structural weaknesses in the financial sector, Germany has strengthened financial sector supervision and has taken steps to align itself with the new EU regulatory framework. An Act to Strengthen German Financial Supervision (*Gesetz zur Stärkung der deutschen Finanzaufsicht*), which entered into force on 1 January 2013, is expected to improve the cooperation between supervisory authorities and the alignment of microprudential and macroprudential oversight. It has established the Financial Stability Board (*Ausschuss für Finanzstabilität*), which consists of the *Bundesbank*, the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht — BaFin*) and the Federal Ministry of Finance and can issue

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22 As regards VAT reform options, see for example Präsident des Bundesrechungshofes (2013), *Chancen zur Sicherung des Umsatzsteueraufkommens. Vorschläge zur Umsetzung wichtiger Reformvorhaben bei der Umsatzsteuer*.

23 Deutsche Bundesbank (2012), *Financial stability review 2012.*

24 European Central Bank (2013), *Bank lending survey*; European Central Bank (2013), *Survey on the access to finance of SMEs in the euro area*; Deutsche Bundesbank (2013), *Monthly Report February 2013*; Ifo Institute (2013), *Ifo Business Survey.*

warnings or recommendations based on *Bundesbank* analysis. Moreover, the federal government recently adopted several draft laws aimed at completing the regulatory framework. These laws deal with extending supervision to alternative investment funds, strengthening independent investment counselling, preventing risks related to high frequency trading, improving supervision of financial conglomerates, facilitating liquidation of financial institutions based on recovery and resolution plans, and separating commercial from investment banking. In addition, new criminal law rules have been brought in to deal with gross violations of their risk management duties by top executives. As for the Financial Market Stabilisation Fund (*Sonderfonds Finanzmarktstabilisierung — Soffin*), which provides capital or guarantees to ailing institutions, this has been extended until 2014.

Although Commission state aid decisions have continued to drive the ad hoc restructuring of *Landesbanken* since last year's CSR, including individual mergers, the overall structure of the sector remains fragmented. In 2012, as a result of Commission state aid decisions, WestLB was wound up and BayernLB and NordLB had to reduce their balance sheets, abandon certain business activities and divest non-core subsidiaries. Amending the corporate structure of and reducing political influence in *Landesbanken* could further facilitate a market-driven consolidation. Moreover, consolidation in the public banking sector could be supported by reviewing the legal structure of the savings banks and allowing their acquisition by *Landesbanken* or private banks, while safeguarding the savings banks' business model, which has proven to be so stable during the crisis.

The German housing market has gained momentum in recent years, although risks for financial stability appear to be limited for the time being. House prices have been rising since 2009, especially in urban centres, on the back of favourable income prospects, low interest rates and a flight of investment into safe assets. Households' robust debt sustainability, the moderate growth in mortgage lending, the favourable labour market and cautious lending standards limit the risks to financial stability. However, sustained low interest rates and high liquidity call for housing market developments to be closely monitored.

3.3. Labour market, education and social policies

The German labour market continues to work well, but there is scope to improve the situation of some people. The Europe 2020 target of a 77% employment rate was close to be achieved in 2012 (76.7%), and at 5.5% in 2012 unemployment remains at a low level, although in some *Länder* the unemployment rate is above 10%. Germany is making efforts to attract skilled workers from abroad, including from Member States with a high level of youth unemployment. Activating the untapped labour and skills potential of the domestic labour pool in line with the 2012 CSR is necessary for mitigating the impact of demographic change, as acknowledged in the NRP. It would also contribute to higher employment and disposable income, thus strengthening domestic demand and supporting rebalancing.

In 2012, the Council Recommendation for Germany contained a CSR concerning reforms in the labour market and education policies. The CSR called for reforms to reduce the tax wedge, in particular for low-wage earners; maintain activation and integration measures, in particular for the long-term unemployed; create the conditions for wages to grow in line with productivity; raise the educational achievement of disadvantaged groups through equal opportunities; phase out fiscal disincentives for second earners; and increase the availability of full-time childcare facilities and all-day schools.

Germany is making progress in integrating the remaining long-term unemployed into the labour market but further efforts are needed. The number of long-term unemployed markedly decreased during the second half of the last decade, but there are still more than one million long-term unemployed and their integration into the labour market is increasingly difficult.[25] It is therefore important to assess how effective the 2011 reform of labour market instruments has been in further integrating the remaining long-term unemployed, and to continue efforts to integrate them.

Germany has made limited efforts to reduce the high tax wedge for low-wage earners and has not taken action to phase out the significant fiscal disincentives faced by second earners (see Section 3.1). Progress in increasing the availability of full-time childcare facilities appears insufficient to meet the estimated needs and remains limited regarding the availability of all-day schools. These factors are reflected in a low share of women working full-time and one of the lowest numbers of hours worked on average by women in the EU, despite a relatively high female employment rate. This contributes to a high gender pay gap and lower pension entitlements for women as compared with men, particularly in the western *Länder*.[26] Progress in increasing the provision of childcare facilities is slow and Germany is unlikely to deliver on its commitments in this area on time. In order to achieve a significantly higher share of full-time female labour participation, more efforts may be required in the future, possibly also regarding the number and flexibility of care hours.[27] Involving the private sector more in the provision of childcare facilities may also be explored. Given the relevance of early childhood education and care to subsequent educational performance, it appears equally important to ensure high-quality early childhood education and care provision by, for example, improving the qualifications of staff.[28] The NRP does not envisage any specific measures in this regard. The effects of the new allowance for families with children under three who do not make use of formal childcare facilities (*Betreuungsgeld*) need to be monitored, as it may create an additional disincentive to work for parents and the risk that more children, especially from low-income families, will not participate in early childhood education and care. The number of all-day schools continues to increase, but the percentage of pupils who attend them remains low at 28 %[29] and in the afternoon such schools often only offer supervision or non-compulsory training. This suggests significant room for improving the potential contribution of all-day schools to high quality education.

Germany is making some progress in raising the educational achievement of disadvantaged people and thus the efficiency of spending on education. The country has made some progress in tackling educational disadvantage during the last decade including by targeted prevention and corrective measures both at the federal and *Länder* level, such as

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25 According to the Federal Employment Agency, in 2011 around half of the long-term unemployed had no vocational training and 40 % of them were 50 years or older (Bundesagentur für Arbeit (2011): *Sockel- und Langzeitarbeitslosigkeit*).

26 In 2010, Germany had the third highest gender pay gap in the EU-27, well above the EU average (22.3 % and 16.2 % respectively). The gender pay gap in the eastern *Länder* is much lower than in the western *Länder* (8 % and 24 %, respectively in 2012). According to the Federal Statistical Office, two thirds of the gender differences in average hourly earnings are explained by the different professional choices made by men and women, differences in the degree of responsibilities and other job requirements, and other factors such as the high incidence of part-time work among women.

27 In the western *Länder,* 20 % of children below three years old are cared for in childcare facilities, less than 40 % of them full-time. 30 % of children between three and six in childcare facilities are cared for full-time (70 % in the eastern *Länder*). (Data for 2011; see KMK and BMBF (2012), *Bildung in Deutschland 2012*).

28 Only 3 % of staff in childcare centres (*Tageseinrichtungen*) have a relevant tertiary degree. Around one third of staff in day-care centres (*Tagespflege*) have followed a pedagogical training, while 41 % have had less than 160 hours of training or no training. (Data for 2011; see KMK and BMBF (2012), *Bildung in Deutschland 2012*).

29 Data for 2010 (see KMK and BMBF (2012), *Bildung in Deutschland 2012*).

initiatives aimed at promoting early language learning,[30] improving children's reading skills or better integrating disadvantaged young people into their social environment. All *Länder* should continue ambitious efforts to create a school system that provides equal opportunities for all. The country is not far from achieving its national target of reducing early school leaving to less than 10% by 2020 (10.5% in 2012), but progress is slow and the rate for foreign-born students is still significantly worse (21.9% in 2011). Better education opportunities for people with a migration background should in time improve their labour market performance. Awareness-raising actions aimed at reducing gender differences in educational and professional choices such as the 'Girl's Days' are welcome, but may not be sufficient.[31] Moreover, lower secondary education does not always sufficiently prepare young people to start vocational training and businesses report difficulties in filling vacant apprenticeship positions with sufficiently skilled people. The implementation of the extended National Training Pact (*Ausbildungspakt*) should alleviate some shortcomings of the system supporting the transition from lower-secondary education to (dual) vocational and educational training *(Übergangssystem)*. Higher participation in tertiary education is mainly explained by the shorter duration of upper secondary school, which temporarily creates double cohorts of students. But measures to help people with dual vocational education and training qualifications gain access to higher education and additional financial support for students also contribute to a positive trend towards higher participation in tertiary education. Despite some progress in increasing adult participation in lifelong learning, Germany still performs below the EU average (7.9% and 9% respectively in 2012), and it is not doing enough to help workers — particularly older workers — to renew or upgrade their skills. Participation is particularly low among low-skilled, unemployed and foreign-born people. The strategy for literacy and basic adult education introduced in 2011 should be monitored. It is important to ensure that the education system provides students with the skills that are necessary to facilitate their integration into the labour market, in particular in fast-changing sectors, and that it encourages entrepreneurship (see also section *Research and Innovation*).

Wages have risen significantly in recent years in line with the 2012 CSR, although not everyone has benefitted to the same extent from these developments. Following a decade of declining real unit labour costs in Germany, real wages have increased stronger than productivity since the beginning of the crisis. Disparities in gross wages among income groups continued to rise in the second half of the last decade, but to a lower extent than in the first half.[32] Wage moderation had contributed to an increasing share of capital income in relation to labour income in gross added value, but this trend has reversed since 2008, most likely due to the favourable development of employment and wages as well as lower returns of capital investments. Real unit labour costs are expected to continue increasing, given significant increases in wages, moderate employment growth and the projected economic recovery. Wage developments are therefore expected to continue to contribute to re-adjusting

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30 The federal campaign 'Early opportunities — focus on language and integration' (*Offensive Frühe Chancen — Schwerpunkt Sprache und Integration*) specifically promotes German language learning at childcare facilities.

31 According to the Federal Statistical Office in 2010 16% of the female high education students in Germany took courses on mathematics, informatics, science or technology, compared with 46% of the male students. The difference between the female and male shares has increased compared with 2001 and remains one of the highest in the EU. See Destatis (2012), *Frauen und Männer auf dem Arbeitsmarkt*.

32 See Federal Statistical Office, 2012, *Niedriglohn und Beschaeftigung 2010*, press conference September 2012 and DIW, 2011, *Schwache Lohnentwicklung im letzten Jahrzehnt,* DIW Wochenbericht, 45. According to the latter study, the tax and social security system mitigate the increase in disparities in gross wages to a significant extent.

macroeconomic imbalances in the euro area as well as to raise living standards in Germany, also benefitting from past structural reforms and adjustments.

Building on the positive results of the last decade's reforms, it is important to further improve the integration of all groups into the labour market, also with a view to improving their income, while preserving employment. An important element of the reforms was the injection of greater flexibility into the labour market, resulting in an increased use of non-regular contracts, including mini-jobs, part-time, fixed-term or temporary agency work.[33] The group of people working in mini-jobs is very heterogeneous.[34] For many (e.g. students, pensioners), mini-jobs provide them with an additional income. On the other hand, the favourable fiscal conditions of mini-jobs may create some distortions by, for instance, discouraging people — especially second earners (see section 3.1, *Tax System*) — from increasing the number of hours they work, or companies from opting for other types of contract.[35] Therefore, it seems appropriate to assess whether there is a need to correct some features of the current system. Moreover, in-work poverty has risen in the last years, which also increases the risk of old-age poverty rising in the future. There is an on-going debate on the possibility of introducing some kind of wage floor or minimum wage in Germany.[36] Wage floors could increase the income of low-wage earners, but would have a positive impact on the overall income of workers only if they do not lead to significant job losses.[37]

3.4. Structural measures promoting growth and competitiveness

In 2012, the Council Recommendation for Germany contained a CSR concerning reforms in the energy, railway and services sectors. The CSR called for reforms to minimise the economic costs of transforming the energy system and to stimulate competition in railway markets and in the services sectors, including professional services and certain crafts, in particular in the construction sector.

Internal market, liberalisation and competition

33 According to the Federal Statistical Office, in 2010 20.6% of all employees and almost half of the employees with non-regular contracts earned less than EUR 10.36 per hour (two thirds of the median earnings).

34 Of the 7.5 million people with mini-jobs at the end of 2011, almost two thirds (4.9 million, two thirds of them women) had only the mini-job; the rest (2.6 million) also had a job subject to social contributions (and they constituted 9% of all employees subject to those contributions). Out of the 4.9 million working only in mini-jobs, 35% were housewives/husbands, 22% pensioners, 20% students and 11% unemployed. Almost 50% of the employees interviewed were satisfied with their situation and 27% were searching for more work (25% would have liked to work more but could not for some reason). Students and pensioners in particular are unlikely to be interested in a regular job, while 73% of the unemployed would like to work more. Körner, T., Meinken, H. and Puch, K. (2013), *Wer sind die ausschließlich geringfügig Beschäftigten? Eine Analyse nach sozialer Lebenslage.* Statistisches Bundesamt, Wirtschaft und Statistik.

35 Hohendanner, C. and Stegmaier, J. (2012) provide some evidence that regular jobs are crowded out by mini-jobs, in particular in small companies. Hohendanner, C. and Stegmaier, J. (2012), *Umstrittene Minijobs*, IAB-Kurzbericht 24/2012.

36 In contrast to most Member States there is no statutory minimum wage in Germany, but there are minimum wages in twelve sectors, including the temporary employment sector. The hairdressing sector recently agreed to introduce a wage floor.

37 The economic impact of minimum wages depends on multiple factors, including the level, the setting mechanism, the possibility of differentiating minimum wages (e.g. across *Länder* or sectors), the interaction with the benefits system, and the characteristics of the sectors concerned (price elasticity, complementarity with other products, share of labour in total costs, previous remuneration structure, level of competition, etc.).

Policy action to improve competition in line with the 2012 CSR has been limited and the NRP does not announce new actions. Reforms to improve competition could contribute to the reallocation of resources and help boost investment in non-tradable sectors, strengthening the shift in the composition of growth towards domestic demand.

The situation in the services sectors has not changed significantly since last year and there continue to be restrictions on accessing and exercising certain professions, but Germany has not announced any actions in its 2013 NRP to address them. In many craft sectors, including in the construction sector, there is still a requirement to hold a master craftsman's certificate (*Meisterbrief*) or an equivalent qualification in order to run a craft business. Building on the experience of the 2004 reform, Germany could consider whether this requirement is still justified in all cases and explore more targeted ways of ensuring that services are provided safely. The construction sector also faces restrictions as regards commercial communication and authorisation procedures. Many professional services are also subject to legal form and shareholding requirements. Germany could assess whether the same public interest objectives could not be reached with lighter regulation. The diversity of regulatory regimes across *Länder* also suggests there is scope for further efforts to identify the least burdensome regulatory approaches and extend them throughout the country, thus cutting red tape for businesses. Moreover, despite long-standing plans to review the regulatory framework in the postal sector, Germany has not made progress and the postal mail market is still dominated by the incumbent operator. It is important that the review is not delayed any further and the regulator is given additional instruments, especially for price and access control. While the German retail sector is performing well overall, in some cases planning regulations may unduly restrict new entries into the market (e.g. by requiring economic needs tests), and discriminate against certain types of retailer. Urban planning objectives such as retaining supply areas in the city centres should be pursued in a competition-neutral manner.[38]

The situation in the railway sector has not changed significantly since last year's recommendation. Germany has adopted a draft law (*Eisenbahnregulierungsgesetz*) aimed at streamlining the principles of network access, easing market access for railway undertakings and granting greater powers to the regulator. Moreover, it has partially opened the long-distance passenger travel market to bus connections, which may enhance competition in the passenger sector. Germany has also undertaken, albeit with some delay, to introduce the Europe-wide rail signalling system ERTMS. This should also stimulate competition in the transport sector by facilitating cross-border rail traffic. However, despite these positive developments, competition in the rail markets remains very limited.[39] Given Germany's central geographical position, this has an impact on the whole European railway system. Improving the level of independence of the infrastructure manager could have a positive impact on competition in the rail markets.[40]

There is scope for improving the institutional framework for more competition. The legislative process involving the revision of the Act against Competition Restrictions, which should enhance effective enforcement of competition law, has not yet been concluded. In addition, Germany could benefit from strengthening the institutional set-up to ensure effective control over state aid by, for example, introducing transparency mechanisms or setting up bodies to check the eligibility of aid awards. Furthermore, the value of the contracts published

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38 See, for example, Monopolkommission (2012), *Neunzehntes Hauptgutachten der Monopolkommission 2010/2011*.

39 In 2011, the market share of new entrants was less than 1 % and 13 % in long-distance and regional passenger transport respectively, and 26 % in freight transport. These markets were opened in 1994.

40 See, for example, Monopolkommission (2011), *Bahn 2011: Wettbewerbspolitik unter Zugzwang, 60. Sondergutachten der Monopolkommission*.

by the German authorities under EU procurement legislation is comparatively low, suggesting scope for improvement.

Energy

Germany is on track to comply with its Europe 2020 renewable energy target and its climate target subject to the implementation of additional measures. Germany is likely to comply with its renewable energy targets before 2020. According to the latest projections, the country will achieve the target regarding greenhouse gas emissions in sectors outside the Emissions Trading Scheme subject to the implementation of additional measures. However, Germany is pursuing a major transformation of the energy system to achieve more ambitious climate and energy targets by 2050, including a substantial increase of renewables in the energy mix.[41]

Policy action aimed at minimising the overall economic costs of transforming the energy system in line with last year's recommendation has not yet led to tangible results and potential major risks and inefficiencies remain. Despite measures taken in the past — including controlling the costs of promoting solar energy — the surcharge paid by electricity consumers to compensate renewables producers for their higher production costs (*EEG-Umlage*) has increased by 47% in 2013 as compared with 2012. Moreover, large sections of the industry benefit from several exemptions which add to the electricity bill of other industrial consumers and households and tend to distort price signals. Increasing the cost-effectiveness of the system to promote renewable energy, including by ensuring that electricity prices send the right signals to all consumers, remains a challenge. The NRP reiterates plans for a fundamental review of the Renewable Energy Act, which is welcome and should not be further delayed. The government had also proposed measures to contain electricity price increases in the short term, but the plans have not been adopted as agreement could not be reached with all relevant parties.[42] Moreover, the government has adopted a draft law setting more ambitious standards for energy efficiency in new buildings, but there is a need for action to increase energy efficiency in existing buildings as well. Past developments suggest that Germany will have to make a significant effort to meet its commitment to reduce energy consumption.

Germany is making efforts to accelerate the expansion of the networks, which is lagging behind. Expanding and upgrading the electricity grid and providing additional storage and flexible generation capacities are pre-requisites for the expansion of renewables. Given the increasing renewable energy production capacities in the North Sea and Baltic Sea areas and the reduced nuclear capacity in the more industrial southern *Länder*, steps need to be taken to expand the internal north-south axis, develop an offshore grid, and expand connections to neighbouring countries to avoid the negative impacts of unscheduled flows. There has been progress in improving the conditions for accelerating the expansion of the electricity network since last year's CSR. In particular, in 2012 the federal government adopted a draft national demand plan (*Bundesbedarfsplan*) following upon the ten-year network development plan (*Netzentwicklungsplan*). The plan aims at accelerating the approval and administrative

41 The Energy Concept (*Energiekonzept*) of 2010 set climate and energy targets up until 2050. The 'energy turnaround' *(Energiewende)* introduced following the Fukushima nuclear disaster in March 2011 provides for the phase-out of all nuclear plants by 2022. Renewable energy is subsidised through a feed-in tariff system to compensate renewable producers for the difference between the production cost and the market price.

42 The government plans included the introduction of a statutory limit to the yearly increase in the renewables surcharge of 2.5%. The plans did not specify which measures would be taken in case this limit would be insufficient to compensate renewable energy producers.

procedures by drawing up a list of projects which are deemed necessary. Moreover, the regulator will be in charge of planning and approval procedures for grids across *Länder* and cross-border grids. Germany also agreed on a future liability regime for offshore wind farm grid connection and an offshore grid development plan. It is important to continue with these efforts, as the first monitoring report on the 'energy turnaround' shows that actual developments are lagging behind. Progress has also been achieved in developing the gas network, but further enhancements are necessary to improve interconnectivity with neighbouring countries, including reverse flows, and new north-south and east-west transport capacity.

More needs to be done to coordinate Germany's energy policy with that of neighbouring countries. The transformation of the country's energy system also affects its neighbours, in particular given its geographical position. Lack of coordination may impact negatively on neighbouring countries and the European energy market by increasing costs, distorting competition or reducing security of supply. Closer coordination of energy policies between Germany and its neighbours would help prevent unnecessary problems and make it easier to benefit from the European energy market, as illustrated by the recent agreement between the German and Polish grid operators regarding coordinated mechanisms to increase cross-border capacities between both countries.

Research and innovation

Germany is one of the EU's innovation leaders but it could still do more. As pointed out in the 2012 SWD, although Germany is one of the innovation leaders in the EU and is already close to achieving its R&D expenditure target of 3% of GDP (see section 3.1), other economies are investing even more in research and innovation. Moreover, significant disparities remain at regional level in terms of R&D investments and innovation performance, underlining the need for smart specialisation strategies at the regional level.

Bottlenecks for start-up companies are hindering the development of high-tech sectors. Fast-growing, innovative start-up companies in information and communication technology, biotechnology and other high-tech sectors continue to face bottlenecks such as skills shortages and lack of finance, including from venture capital and business angels. The federal government already supports start-up companies with financing instruments, but there is a need to further improve the regulatory framework and to stimulate private investment. It is also important to adapt the educational system to the changing requirements of technology and innovation by developing, for example, entrepreneurship and knowledge transfer. Germany has taken initiatives aimed at attracting and retaining students and academics from abroad, but more efforts are needed to use the female talent in science and technology throughout the different stages of the research career.[43]

3.5. Modernisation of public administration

The business environment is generally favourable, but could still be further improved in certain areas. The NRP does not announce any additional concrete measures in this respect. Germany systematically assesses the administrative burden associated with newly proposed regulations at federal level. Despite efforts to further reduce the administrative burden, estimated compliance costs have increased overall by EUR 1.3 billion since 2011.[44]

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[43] See Expertenkommission Forschung and Innovation (2013), *Gutachten zu Forschung, Innovation and technologischer Leistungsfähigkeit Deutschlands*.

[44] See Nationaler Normenkontrollrat, *Monitor Erfüllungsaufwand*.

Moreover, not all measures agreed in December 2011 by the federal government have been implemented yet. Defining a new target for additional simplification measures could help stimulate the process. Positive developments have recently been noted for example in respect of standards for e-government and electronic invoicing. In general, small and medium-sized enterprises in particular would benefit from further simplification of the tax system. Moreover, there may be room for further improvement with respect to the time and cost of starting a business and obtaining the necessary licences. The availability of online procedures could also be further improved and the limitations of the points of single contact, which differ across *Länder* in terms of procedures or the information they provide, should be addressed.

4. OVERVIEW TABLE

2012 commitments	Summary assessment
Country-specific recommendations (CSRs)	
CSR 1: Continue with sound fiscal policies to achieve the MTO by 2012. To this end, implement the budgetary strategy as envisaged, ensuring compliance with the expenditure benchmark as well as sufficient progress towards compliance with the debt reduction benchmark. Continue the growth- friendly consolidation course through additional efforts to enhance the efficiency of public spending on healthcare and long-term care, and by using untapped potential to improve the efficiency of the tax system; use available scope for increased and more efficient growth-enhancing spending on education and research at all levels of government. Complete the implementation of the debt brake in a consistent manner across all *Länder*, ensuring timely and relevant monitoring procedures and correction mechanisms.	Significant progress in achieving fiscal targets and implementing the budgetary strategy as envisaged. The general government budget produced a small surplus and the MTO was met in 2012. Limited progress in further enhancing the efficiency of public spending on healthcare and long-term care and of the tax system. Germany appears to be well on track with respect to the national target on education and research expenditure, but may consider more ambitious follow-up targets. Limited progress in the implementation of the constitutional debt brake at *Länder* level, in particular with respect to specifying implementing rules.
CSR 2: Address the remaining structural weaknesses in the financial sector, inter alia, by further restructuring of those *Landesbanken* which are in need of an adequately funded viable business model while avoiding excessive deleveraging.	Significant progress in strengthening the regulatory and supervisory framework in the financial sector. Progress in restructuring of *Landesbanken* based on Commission state aid decisions.
CSR 3: Reduce the high tax wedge in a budgetary neutral way, in particular for low-wage earners, and maintain appropriate activation and integration measures, in particular for the long-term unemployed. Create the conditions for wages to grow in line with productivity. Take measures to raise the educational achievement of disadvantaged groups, in particular through ensuring equal opportunities in the education and training system. Phase out the fiscal disincentives for second earners, and increase the availability of fulltime childcare facilities and all-day schools.	Limited progress to reduce the high tax wedge. Insufficient progress on integrating the long-term unemployed into the labour market. Significant progress in wage growth. Insufficient progress in raising the educational achievement of disadvantaged groups. No progress on phasing out fiscal disincentives for second earners. Progress in increasing the availability of full-time childcare facilities is insufficient to meet the estimated needs. Progress regarding the availability of all-day schools remains limited.
CSR 4: Continue efforts to keep the overall economic costs of transforming the energy system to a minimum, including by accelerating the expansion of the national and cross-border electricity and gas networks. Ensure that the institutional set- up guarantees effective competition in railway markets. Take measures to further stimulate competition in the services sectors, including professional services and certain crafts, in particular in the construction sector.	Insufficient progress in minimising the costs of transforming the energy system. Some progress in setting the conditions for accelerating the expansion of the networks. Limited progress in ensuring competition in the railway markets. Limited progress in stimulating competition in the service sectors.

Europe 2020 (national targets and progress)	
Employment rate target: 77% of the population aged 20-64.	Employment rate of the population aged 20-64: 76.7% in 2012. Employment rate of women: 71.5% in 2012 (national target: 73%). Employment rate of the population aged 55-64: 61.5% in 2012 (national target: 60%).
R&D target: 3% of GDP.	R&D expenditure: 2.84% of GDP in 2011.
Greenhouse gas emissions target: -14% (compared to 2005 emissions, ETS emissions are not covered by this national target).	Change in non-ETS greenhouse gas emissions between 2005 and 2011: -9%. According to the latest national projections submitted to the Commission and taking into account existing measures, the target is expected to be missed: -10% in 2020 compared with 2005.
Renewable energy target: 18% Share of renewable energy in the transport sector: 10%	Share of renewable energy in gross final energy consumption: 12.3% in 2011 (6.1% in transport. Only formally reported compliant biofuels with Art. 17 and 18 of Directive 2009/28/EC are included).
Indicative national energy efficiency target: reduction of primary energy consumption by 20% compared to 2008.	Germany has set an indicative national energy efficiency target in accordance with Articles 3 and 24 of the Energy Efficiency Directive (2012/27/EU). However, Germany has not specified the target in terms of an absolute level of primary and final energy consumption in 2020, as required, and has not provided information on which data basis the target has been calculated.
Early school leaving target: < 10.	Early leavers from education and training: 10.5% of the population aged 18-24 in 2012 (provisional data).
Tertiary education target: 42% of the population aged 30-34.	Tertiary education attainment: 42.2% in 2011 (including ISCED 4, considered as equivalent to tertiary attainment and included in the national target).
Risk of poverty or social exclusion target: 20% reduction in the number of long-term unemployed by 2020 compared with 2008 (i.e. reduction by 320.000 long-term unemployed).	Reduction in the long-term unemployed: 430.000 in 2012 compared with 2008.

5. ANNEX

Table I. Macroeconomic indicators

	1995-1999	2000-2004	2005-2009	2010	2011	2012	2013	2014
Core indicators								
GDP growth rate	1.6	1.1	0.7	4.2	3.0	0.7	0.4	1.8
Output gap [1]	-0.2	0.1	-0.4	-1.0	0.7	0.0	-1.0	-0.5
HICP (annual % change)	1.0	1.5	1.8	1.2	2.5	2.1	1.8	1.6
Domestic demand (annual % change) [2]	1.6	0.1	0.6	2.6	2.6	-0.4	0.2	1.9
Unemployment rate (% of labour force) [3]	9.0	9.0	9.1	7.1	5.9	5.5	5.4	5.3
Gross fixed capital formation (% of GDP)	21.3	19.0	17.9	17.4	18.1	17.6	17.4	17.6
Gross national saving (% of GDP)	20.9	20.6	24.3	23.6	23.9	23.6	22.9	22.8
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-3.9**	**-2.7**	**-1.6**	**-4.1**	**-0.8**	**0.2**	**-0.2**	**0.0**
Gross debt	**59.1**	**62.1**	**68.6**	**82.4**	**80.4**	**81.9**	**81.1**	**78.6**
Net financial assets	**-32.5**	**-40.2**	**-46.8**	**-50.0**	**-51.5**	**n.a**	**n.a**	**n.a**
Total revenue	45.8	44.5	44.0	43.6	44.5	45.2	45.2	45.1
Total expenditure	49.7	47.2	45.6	47.7	45.3	45.0	45.4	45.1
of which: Interest	3.4	3.0	2.8	2.5	2.6	2.5	2.4	2.3
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-0.3**	**-0.9**	**1.8**	**4.3**	**1.1**	**0.8**	**1.4**	**1.3**
Net financial assets; non-financial corporations	**-51.9**	**-52.7**	**-56.0**	**-59.4**	**-52.3**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**-1.4**	**-6.8**	**-3.8**	**4.1**	**3.7**	**n.a**	**n.a**	**n.a**
Gross capital formation	11.5	11.2	10.6	9.9	10.3	9.5	8.7	8.8
Gross operating surplus	21.1	22.3	24.8	24.7	24.2	23.2	22.7	23.3
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**3.3**	**5.0**	**6.0**	**6.0**	**5.2**	**5.3**	**5.1**	**4.7**
Net financial assets	**86.9**	**100.9**	**117.9**	**125.1**	**122.1**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	43.6	43.1	40.9	41.4	41.8	42.6	43.2	43.3
Net property income	11.0	12.0	14.1	13.8	14.1	14.3	14.3	14.6
Current transfers received	22.5	23.0	22.0	22.0	21.1	21.0	20.7	20.4
Gross saving	11.0	10.8	11.6	11.7	11.3	11.4	11.2	10.9
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-0.9**	**1.4**	**6.2**	**6.1**	**5.6**	**6.3**	**6.3**	**6.0**
Net financial assets	**-0.5**	**0.7**	**-8.5**	**-15.3**	**-16.9**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	1.0	3.2	5.8	5.6	5.1	5.7	5.7	5.5
Net primary income from the rest of the world	-0.9	-0.7	1.7	2.0	1.9	1.9	1.8	1.7
Net capital transactions	0.0	0.1	0.0	0.0	0.0	-0.1	-0.1	0.0
Tradable sector	41.5	41.7	41.6	41.2	42.0	41.9	n.a	n.a
Non tradable sector	48.9	48.4	48.1	48.4	47.4	47.5	n.a	n.a
of which: Building and construction sector	5.6	4.2	3.7	4.0	4.1	4.1	n.a	n.a
Real effective exchange rate (index, 2000=100)	115.3	100.5	97.2	94.3	94.6	93.4	96.5	97.2
Terms of trade goods and services (index, 2000=100)	102.3	100.3	99.3	99.2	96.9	96.3	96.1	96.0
Market performance of exports (index, 2000=100)	91.7	96.0	105.4	111.3	115.2	119.5	120.8	123.0

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

[2] The indicator on domestic demand includes stocks.

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

Source :

Commission services' 2013 spring forecasts (COM); Stability programme (SP).

Table II. Comparison of macroeconomic developments and forecasts

	2012		2013		2014		2015	2016	2017
	COM	**SP**	**COM**	**SP**	**COM**	**SP**	**SP**	**SP**	**SP**
Real GDP (% change)	0.7	0.7	0.4	0.4	1.8	1.6	1.4	1.4	1.4
Private consumption (% change)	0.6	0.6	0.8	0.6	1.4	1.0	1.2	1.2	1.2
Gross fixed capital formation (% change)	-2.5	-2.5	-0.6	0.5	3.9	4.1	2.8	2.8	2.8
Exports of goods and services (% change)	3.7	3.7	2.2	2.8	6.2	4.4	4.8	4.8	4.8
Imports of goods and services (% change)	1.8	1.8	2.1	3.5	7.0	4.5	5.3	5.3	5.3
Contributions to real GDP growth:									
- Final domestic demand	0.2	-0.3	0.7	0.6	1.8	1.5	1.4	1.4	1.4
- Change in inventories	-0.5	-0.5	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	1.0	1.0	0.2	-0.1	0.0	0.2	0.0	0.0	0.0
Output gap[1]	0.0	0.0	-1.0	-1.0	-0.5	-0.8	-0.5	-0.2	0.1
Employment (% change)	1.1	1.1	0.5	0.0	0.5	0.2	0.2	0.2	0.2
Unemployment rate (%)	5.5	5.3	5.4	5.4	5.3	5.1	4.9	4.6	4.4
Labour productivity (% change)	-0.4	-0.4	-0.1	0.4	1.3	1.4	1.2	1.2	1.2
HICP inflation (%)	2.1	n.a.	1.8	n.a.	1.6	n.a.	n.a.	n.a.	n.a.
GDP deflator (% change)	1.3	1.3	1.5	1.8	1.7	1.7	1.6	1.6	1.6
Comp. of employees (per head, % change)	2.5	2.5	2.4	2.3	3.1	2.7	2.5	2.5	2.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	6.3	6.3	6.3	6.2	6.0	6.2	6.0	5.9	5.7

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission services' 2013 spring forecasts (COM); Stability programme (SP).

Table III. Composition of the budgetary adjustment

(% of GDP)	2012	2013		2014		2015	2016	2017	Change: 2012-2017
	COM	COM	SP	COM[1]	SP	SP	SP	SP	SP
Revenue	**45.2**	**45.2**	**45**	**45.1**	**45**	**45**	**44½**	**44½**	**-0.6**
of which:									
- Taxes on production and imports	11.3	11.3	11½	11.2	11	11	11	11	-0.5
- Current taxes on income, wealth, etc.	12.1	12.3	12½	12.4	12½	12½	13	13	0.8
- Social contributions	17.0	16.9	17	16.8	16½	16½	16½	16½	-0.3
- Other (residual)	4.8	4.8	4.7	4.8	4.6	4.4	4.3	4.2	-0.6
Expenditure	**45.0**	**45.4**	**45½**	**45.1**	**44½**	**44½**	**44½**	**44**	**-1.0**
of which:									
- Primary expenditure	42.5	43.0	43	42.9	42	42	42	42	-0.7
of which:									
Compensation of employees and intermediate consumption	12.6	12.9	12½	12.9	12½	12½	12	12	-0.5
Social payments	24.4	24.6	24½	24.5	24½	24½	24½	24½	0.2
Subsidies	0.9	0.9	1	0.9	1	1	1	1	0.1
Gross fixed capital formation	1.5	1.5	1½	1.5	1½	1½	1½	1½	-0.1
Other (residual)	3.1	3.1	3	3.1	3	3	3	3	-0.1
- Interest expenditure	2.5	2.4	2½	2.3	2½	2½	2½	2	-0.3
General government balance (GGB)	**0.2**	**-0.2**	**-½**	**0.0**	**0**	**0**	**½**	**½**	**0.4**
Primary balance	**2.6**	**2.3**	**2**	**2.3**	**2½**	**2½**	**2½**	**3**	**0.2**
One-off and other temporary measures	-0.1	0.0	0	0.0	0	0	0	0	0.1
GGB excl. one-offs	**0.3**	**-0.2**	**-0.3**	**0.0**	**0.2**	**0.2**	**0.4**	**0.6**	**0.3**
Output gap[2]	0.0	-1.0	-1.0	-0.5	-0.8	-0.5	-0.2	0.1	0.1
Cyclically-adjusted balance[2]	0.2	0.4	0.3	0.3	0.7	0.5	0.5	0.6	0.4
Structural balance (SB)[3]	**0.3**	**0.4**	**0.3**	**0.3**	**0.7**	**0.5**	**0.5**	**0.6**	**0.3**
Change in SB	*1.3*	*0.1*	*0.0*	*-0.1*	*0.4*	*-0.2*	*0.0*	*0.1*	-
Two year average change in SB	*1.3*	*0.7*	*0.6*	*0.0*	*0.2*	*0.1*	*-0.1*	*0.0*	-
Structural primary balance[3]	2.8	2.8	2.7	2.6	3.0	2.8	2.8	2.8	0.0
Change in structural primary balance		*0.0*	*-0.1*	*-0.2*	*0.3*	*-0.2*	*0.0*	*0.0*	-
Expenditure benchmark									
Applicable reference rate[4]	0.01	1.16	1.16	1.08	1.08	1.08	1.08	n.a.	-
Deviation[5] (% GDP)	-0.2	-0.2	0.6	0.0	-0.4	0.0	-0.2	n.a.	-
Two-year average deviation (% GDP)	-0.7	-0.2	0.0	-0.1	0.1	-0.2	-0.1	n.a.	-

Notes:

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

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

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

[4] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A lower rate applies as long as the country is adjusting towards its MTO, including in year t.The reference rates applicable to 2014 onwards have been updated in 2013.

[5] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A positive sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Stability programme (SP); Commission services' 2013 spring forecasts (COM); Commission services' calculations.

Table IV. Debt dynamics

(% of GDP)	Average 2007-2011	2012	2013		2014		2015	2016	2017
			COM	SP	COM	SP	SP	SP	SP
Gross debt ratio[1]	**73.9**	**81.9**	**81.1**	**80½**	**78.6**	**77½**	**75**	**71½**	**69**
Change in the ratio	2.5	1.5	-0.8	-1.5	-2.5	-2.7	-2.9	-3.1	-2.8
Contributions[2] *:*									
1. Primary balance	**-1.1**	**-2.6**	**-2.3**	**-2.1**	**-2.3**	**-2.5**	**-2.5**	**-2.6**	**-2.8**
2. "Snow-ball" effect	**1.0**	**0.9**	**0.9**	**0.6**	**-0.5**	**-0.2**	**0.1**	**0.0**	**0.1**
Of which:									
Interest expenditure	2.7	2.5	2.4	2.4	2.3	2.3	2.3	2.2	2.2
Growth effect	-0.9	-0.5	-0.3	-0.3	-1.4	-1.2	-1.1	-1.0	-1.0
Inflation effect	-0.7	-1.0	-1.2	-1.5	-1.3	-1.3	-1.2	-1.1	-1.1
3. Stock-flow adjustment	**2.6**	**3.2**	**0.6**	**0.0**	**0.3**	**0.1**	**-0.4**	**-0.5**	**-0.1**
Of which:									
Cash/accruals diff.									
Acc. financial assets									
Privatisation									
Val. effect & residual									

	2012	2013		2014		2015	2016	2017
		COM/ SP[3]	SP[4]	COM/ SP[3]	SP[4]	SP	SP	SP
Gap to the debt benchmark[5,6]	n.r.	n.r.	n.r.	-4.4	-4.1	-4.3	-4.4	n.r.
Structural adjustment[7]	1.2	0.0	0.0	n.r.	n.r.	n.r.	n.r.	n.r.
To be compared to:								
Required adjustment[8]	-0.1	-1.1	-1.1	n.r.	n.r.	n.r.	n.r.	n.r.

Notes:

[1]End of period.

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

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

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

[5]Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

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

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

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

Source :

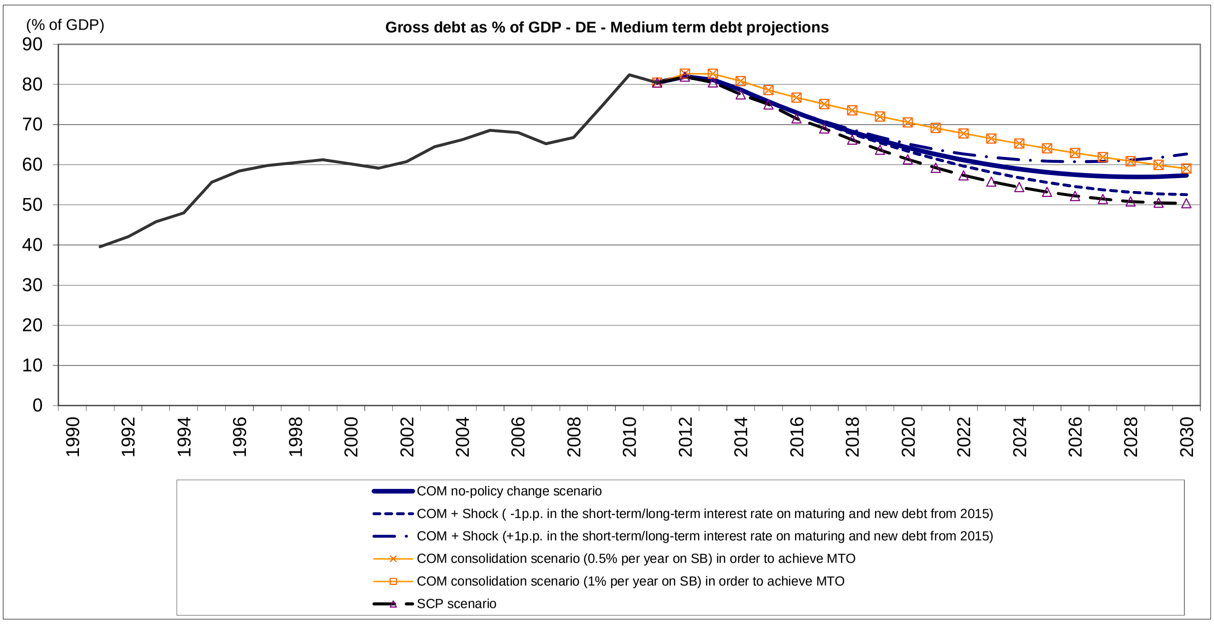
Stability programme (SP); Commission services' spring 2013 forecasts (COM); Commission services' calculations.

Table V. Sustainability indicators

	DE		EU27	
	No-policy change scenario	Programme (SCP) scenario	No-policy change scenario	Programme (SCP) scenario
S2	1.4	1.2	3.0	1.3
of which:				
Initial budgetary position (IBP)	-1.1	-1.3	0.8	-0.9
Long-term cost of ageing (CoA)	2.4	2.4	2.2	2.2
of which:				
Pensions	1.5	1.4	1.0	1.1
Health care	0.9	0.8	0.9	0.8
Long-term care	0.1	0.1	0.6	0.6
Others	0.0	0.1	-0.4	-0.3
S1 (required adjustment)*	-0.3	-0.9	2.2	0.5
of which:				
Initial budgetary position (IBP)	-2.1	-2.5	0.0	-1.8
Debt requirement (DR)	1.1	0.7	1.9	1.9
Long-term cost of ageing (CoA)	0.7	0.9	0.3	0.4
S0 (risk for fiscal stress)**	0.02		:	
Debt, % of GDP (2012)	81.9		87.0	
Age-related expenditure, % of GDP (2012)	24.8		25.8	

Note:
The 'No-policy change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves according to the Commissions' spring 2013 forecast until 2014. The 'Programme (SCP)' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented.
* The required adjustment of the primary balance until 2020 to reach a public debt of 60% of GDP by 2030.
** The critical threshold for the S0 indicator is 0.44.

Source :
Commission services; 2013 stability programme.



Gross debt as % of GDP - DE - Medium term debt projections
(% of GDP)
90
80
70
60
50
40
30
20
10
0
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012
2014
2016
2018
2020
2022
2024
2026
2028
2030
COM no-policy change scenario
COM + Shock (-1p.p. in the short-term/long-term interest rate on maturing and new debt from 2015)
COM + Shock (+1p.p. in the short-term/long-term interest rate on maturing and new debt from 2015)
COM consolidation scenario (0.5% per year on SB) in order to achieve MTO
COM consolidation scenario (1% per year on SB) in order to achieve MTO
SCP scenario

Table VI. Taxation indicators

	2002	2006	2008	2009	2010	2011
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	38.9	38.6	38.9	39.3	37.9	38.7
Breakdown by economic function (% of GDP)[1]						
Consumption	10.4	10.2	10.7	11.2	10.7	10.9
of which:						
- VAT	6.4	6.4	7.1	7.5	7.2	7.3
- excise duties on tobacco and alcohol	0.8	0.8	0.7	0.7	0.7	0.7
- energy	2.2	2.0	1.8	1.9	1.8	1.8
- other (residual)	1.0	1.0	1.0	1.1	1.0	1.1
Labour employed	20.7	19.0	18.9	19.4	18.7	19.0
Labour non-employed	2.9	2.9	2.7	2.9	2.8	2.6
Capital and business income	3.8	5.4	5.6	4.8	4.7	5.1
Stocks of capital/wealth	1.1	1.1	1.1	1.1	1.0	1.1
p.m. Environmental taxes[2]	2.5	2.4	2.2	2.3	2.2	2.3
VAT efficiency[3]						
Actual VAT revenues as % of theoretical revenues at standard rate	56.5	56.9	55.6	55.5	54.8	55.6

Note:

[1] Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2013) Taxation trends in the European Union, for a more detailed explanation.

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

[3] The VAT efficiency is measured via the VAT revenue ratio. The VAT revenue ratio is defined as the ratio between the actual VAT revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). See European Commission (2012), Tax reforms in EU Member States, European Economy 6/2012 and Taxation Papers 34/2012 for a more detailed explanation.

Source: Commission

Table VII. Financial market indicators

	2008	2009	2010	2011	2012
Total assets of the banking sector (% of GDP)	319.1	313.2	332.7	323.7	311.2
Share of assets of the five largest banks (% of total assets)	22.7	25.0	32.6	33.5	…
Foreign ownership of banking system (% of total assets)	11.5	10.8	…	…	…
Financial soundness indicators:					
- non-performing loans (% of total loans)[1)]	2.9	3.3	3.2	3.0	...
- capital adequacy ratio (%) [2)]	13.6	14.8	16.1	16.4	17.3
- return on equity (%) [3)]	-2.5	5.0	8.8	...	...
Bank loans to the private sector (year-on-year % change)	4.4	0.0	0.0	2.0	1.1
Lending for house purchase (year-on-year % change)	-0.6	0.2	0.7	1.2	1.9
Loan to deposit ratio	89.6	87.6	85.6	83.3	82.5
CB liquidity as % of liabilities	4.9	3.6	1.9	1.3	1.2
Banks' exposure to countries receiving official financial assistance (% of GDP)[4)]	17.0	16.6	12.4	10.1	8.4
Private debt (% of GDP)	107.3	111.3	107.5	103.2	102.4
Gross external debt (% of GDP)[5)]					
- Public	34.7	38.8	43.5	49.0	50.3
- Private	37.8	39.9	41.2	42.5	43.4
Long term interest rates spread versus Bund (basis points)*	0.0	0.0	0.0	0.0	0.0
Credit default swap spreads for sovereign securities (5-year)*	21.7	37.5	39.8	65.6	68.8

Notes:

1) Latest data (December 2011). Methodological break in 2009 due to changes in the regulatory reporting framework for the audit of banks.

2) Latest data (September 2012).

3) Latest data (December 2010). Only domestically incorporated deposit-takers are included, along with their dependent domestic and foreign

4) Covered countries are CY, EL, ES, LV, HU, IE, PT and RO.

5) Latest data 2012Q3.

* Measured in basis points.

Source:

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

Table VIII. Labour market and social indicators

Labour market indicators	2007	2008	2009	2010	2011	2012
Employment rate (% of population aged 20-64)	72.9	74.0	74.2	74.9	76.3	76.7
Employment growth (% change from previous year)	1.7	1.2	0.1	0.6	1.4	1.1
Employment rate of women (% of female population aged 20-64)	66.7	67.8	68.7	69.6	71.1	71.6
Employment rate of men (% of male population aged 20-64)	79.1	80.1	79.6	80.1	81.4	81.8
Employment rate of older workers (% of population aged 55-64)	51.3	53.7	56.1	57.7	59.9	61.5
Part-time employment (% of total employment, 15 years and more)	26.1	25.9	26.1	26.2	26.6	26.7
Part-time employment of women (% of women employment, 15 years and more)	46.1	45.7	45.4	45.5	45.7	45.7
Part-time employment of men (% of men employment, 15 years and more)	9.4	9.3	9.6	9.7	10.3	10.5
Fixed term employment (% of employees with a fixed term contract, 15 years and more)	14.6	14.7	14.5	14.7	14.7	13.9
Transitions from temporary to permanent employment	2.2	2.5	2.5	3.2	:	:
Unemployment rate1 (% of labour force, age group 15-74)	8.7	7.5	7.8	7.1	5.9	5.5
Long-term unemployment rate2 (% of labour force)	4.9	4.0	3.5	3.4	2.8	2.5
Youth unemployment rate (% of youth labour force aged 15-24)	11.9	10.6	11.2	9.9	8.6	8.2
Youth NEET rate (% of population aged 15-24)	8.9	8.4	8.8	8.3	7.5	7.7
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	12.5	11.8	11.1	11.9	11.7	10.5
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	26.5	27.7	29.4	29.8	30.7	31.9
Formal childcare (from 1 to 29 hours; % over the population less than 3 years)	8.0	10.0	7.0	7.0	9.0	:
Formal childcare (30 hours or over; % over the population less than 3 year)	9.0	9.0	12.0	13.0	15.0	:
Labour productivity per person employed (annual % change)	1.5	-0.1	-5.2	3.6	1.6	-0.4
Hours worked per person employed (annual % change)	-0.1	0.0	-2.7	1.7	0.0	-0.7
Labour productivity per hour worked (annual % change; constant prices)	1.7	-0.1	-2.5	1.8	1.6	0.3
Compensation per employee (annual % change; constant prices)	-0.8	1.3	-1.0	1.4	2.2	1.0
Nominal unit labour cost growth (annual % change)	-0.8	2.3	5.6	-1.1	1.4	2.9
Real unit labour cost growth (annual % change)	-2.3	1.5	4.4	-2.0	0.6	1.6

Notes:

[1] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed.

[2] Long-term unemployed are unemployed persons for at least 12 months.

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

Expenditure on social protection benefits (% of GDP)	**2006**	**2007**	**2008**	**2009**	**2010**
Sickness/Health care	8.10	8.03	8.27	9.70	9.49
Invalidity	2.32	2.22	2.27	2.44	2.41
Old age and survivors	11.90	11.44	11.43	12.20	11.85
Family/Children	2.88	2.77	2.83	3.16	3.20
Unemployment	1.85	1.55	1.44	1.90	1.70
Housing and Social exclusion n.e.c.	0.65	0.61	0.58	0.65	0.63
Total	27.87	26.80	26.98	30.23	29.44
of which: means tested benefits	3.48	3.28	3.25	3.58	0.00

Social inclusion indicators	**2007**	**2008**	**2009**	**2010**	**2011**
At-risk-of-poverty or social exclusion[1] (% of total population)	20.6	20.1	20.0	19.7	19.9
At-risk-of-poverty or social exclusion of children (% of people aged 0-17)	19.7	20.1	20.4	21.7	19.9
At-risk-of-poverty or social exclusion of elderly (% of people aged 65+)	16.8	15.5	16.0	14.8	15.3
At-Risk-of-Poverty rate[2] (% of total population)	15.2	15.2	15.5	15.6	15.8
Severe Material Deprivation[3] (% of total population)	4.8	5.5	5.4	4.5	5.3
Share of people living in low work intensity households[4] (% of people aged 0-59)	11.4	11.6	10.8	11.1	11.1
In-work at-risk-of poverty rate (% of persons employed)	7.5	7.1	6.8	7.2	7.7
Impact of social transfers (excluding pensions) on reducing poverty	38.7	37.2	35.7	35.5	37.1
Poverty thresholds, expressed in national currency at constant prices[5]	10666	10743	10609	10710	10730
Gross disposable income (households)	1608980	1653050	1647450	1695520	1751070
Relative median poverty risk gap (60% of median equivalised income, age: total)	23.2	22.2	21.5	20.7	21.4

Notes:

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

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

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

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

[5] For EE, CY, MT, SI, SK, thresholds in nominal values in Euros; HICP - index 100 in 2006 (2007 survey refers to 2006 incomes)

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

Table IX. Product market performance and policy indicators

Performance indicators	2003-2007	2008	2009	2010	2011	2012
Labour productivity[1] total economy (annual growth in %)	1.6	-0.1	-5.2	3.6	1.6	-0.4
Labour productivity[1] in manufacturing (annual growth in %)	5.8	-4.6	-19.9	21.5	6.3	-2.3
Labour productivity[1] in electricity, gas, steam and air conditioning supply (annual growth in %)	-0.1	3.3	6.2	2.7	-8.2	n.a.
Labour productivity[1] in the construction sector (annual growth in %)	-0.7	0.4	-6.9	5.6	2.9	-3.8
Total number of patent[2] applications per million of labour force	573.7	546.4	536.9	524.9	n.a.	n.a.
Policy indicators	**2003-2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Enforcing contracts[3] (days)	398	394	394	394	394	394
Time to start a business[3] (days)	31	18	18	15	15	15
R&D expenditure (% of GDP)	2.5	2.7	2.8	2.8	2.8	n.a.
Tertiary educational attainment (% of 30-34 years old population)	26.1	27.7	29.4	29.8	30.7	n.a.
Total public expenditure on education (% of GDP)	4.57	4.57	5.06	n.a.	n.a.	n.a.
	2007	**2008**	**2009**	**2010**	**2011**	**2012**
Product market regulation[4], Overall (Index; 0=not regulated; 6=most regulated)	n.a.	1.3	n.a.	n.a.	n.a.	n.a.
Product market regulation[4], Retail (Index; 0=not regulated; 6=most regulated)	n.a.	2.4	n.a.	n.a.	n.a.	n.a.
Product market regulation[4], Network Industries[5] (Index; 0=not regulated; 6=most regulated)	1.1	n.a.	n.a.	n.a.	n.a.	n.a.

Notes:

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

[2] Total number of patent applications to the European Patent Office (EPO) per million of labour force

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

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

[5] Aggregate Energy, Transport and Communications Regulation (ETCR).

*figure for 2007.

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

Table X. Green Growth

		2002-2006	2007	2008	2009	2010	2011
Green Growth performance							
Macroeconomic							
Energy intensity	kgoe / €	0.17	0.15	0.15	0.15	0.15	0.14
Carbon intensity	kg / €	0.48	0.43	0.43	0.42	0.42	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	0.62	0.58	0.57	0.57	n.a.	n.a.
Waste intensity	kg / €	n.a.	n.a.	0.16	n.a.	0.16	n.a.
Energy balance of trade	% GDP	-2.2%	-2.4%	-3.5%	-2.5%	-2.9%	-3.7%
Energy weight in HICP	%	n.a.	11	12	12	12	12
Difference between change energy price and inflation	%	n.a.	1.4	8.6	-2.6	-0.8	7
Environmental taxes over labour taxes	ratio	11.2%	10.5%	10.2%	10.3%	10.3%	n.a.
Environmental taxes over total taxes	ratio	6.6%	5.7%	5.7%	5.9%	5.8%	n.a.
Sectoral							
Industry energy intensity	kgoe / €	0.12	0.11	0.11	0.11	0.12	n.a.
Share of energy-intensive industries in the economy	% GDP	10.3	10.8	10.9	3.1	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.10	0.11	0.11	0.12	0.12
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	0.04	0.05	0.04	0.04	0.05
Public R&D for energy	% GDP	n.a.	0.03%	0.03%	0.04%	0.04%	0.04%
Public R&D for the environment	% GDP	n.a.	0.02%	0.02%	0.03%	0.03%	0.02%
Recycling rate of municipal waste	ratio	60.8%	74.7%	76.7%	77.2%	76.2%	n.a.
Share of GHG emissions covered by ETS*	%	n.a.	49.9%	48.5%	47.0%	48.2%	49.1%
Transport energy intensity	kgoe / €	n.a.	0.48	0.46	0.50	n.a.	n.a.
Transport carbon intensity	kg / €	n.a.	1.21	1.15	1.25	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	n.a.	58.1%	60.5%	61.5%	59.8%	61.1%
Diversification of oil import sources	HHI	n.a.	0.13	0.12	0.13	0.13	n.a.
Diversification of energy mix	HHI	n.a.	0.24	0.25	0.24	0.24	0.24
Share renewable energy in energy mix	%	n.a.	7.7%	7.8%	8.5%	9.7%	9.9%

Country-specific notes:

The year 2012 is not included in the table due to lack of data.

General explanation of the table items:

Source: Eurostat unless indicated otherwise; ECFIN elaborations indicated below

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)

Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)

Carbon intensity: Greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)

Resource intensity: Domestic Material Consumption (in kg) divided by GDP (in EUR)

Waste intensity: waste (in kg) divided by GDP (in EUR)

Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP

Energy weight in HICP: the share of the "energy" items in the consumption basket used in the construction of the HICP

Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual %-change)

Environmental taxes over labour or total taxes: from DG TAXUD's database "Taxation trends in the European Union"

Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)

Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP

Electricity and gas prices medium industrial users: consumption band 500 - 2000MWh and 10000 - 100000 GJ; figures excl. VAT.

Recycling rate of municipal waste: ratio of municipal waste recycled over total municipal waste

Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP

Share of GHG emissions covered by ETS: based on greenhouse gas emissions as reported by Member States to EEA (excl LULUCF)

Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transp industry gross value added (2005 EUR)

Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector

Energy import dependency: net energy imports divided by gross inland energy consumption incl. energy consumption international bunkers

Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin

Diversification of the energy mix: Herfindahl Index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels

Share renewable energy in energy mix: %-share in gross inland energy consumption, expressed in tonne oil equivalents

*Provisional data (15 April 213). Commission Services and EEA.

** For 2007 average of S1 & S2 for DE, LU, NL, FI, SE & UK. Other countries only have S2.

*** For 2007 average of S1 & S2 for IT, NL, FI, SE & UK. Other countries only have S2.