COUNCIL OF
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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject:	COUNCIL RECOMMENDATION on the National Reform Programme 2011 of Germany and delivering a Council opinion on the updated Stability Programme of Germany, 2011-2014

COUNCIL RECOMMENDATION

of

on the National Reform Programme 2011 of Germany
and delivering a Council opinion
on the updated Stability Programme of Germany, 2011-2014

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 5(3) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

After consulting the Economic and Financial Committee,

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[1] OJ L 209, 2.8.1997, p. 1.

Whereas:

(1) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for jobs and growth, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, adopted a decision on guidelines for the employment policies of the Member States[1], which together form the "integrated guidelines". Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

(3) On 12 January 2011, the Commission adopted the first Annual Growth Survey, marking the start of a new cycle of economic governance in the EU and the first European semester of ex-ante and integrated policy coordination, which is anchored in the Europe 2020 strategy.

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1 Maintained for 2011 by Council Decision 2011/308/EU of 19 May 2011 on guidelines for the employment policies of the Member States (OJ L 138, 26.5.2011, p. 56).

(4) On 25 March 2011, the European Council endorsed the priorities for fiscal consolidation and structural reform (in line with the Council's conclusions of 15 February and 7 March 2011 and further to the Commission's Annual Growth Survey). It underscored the need to give priority to restoring sound budgets and fiscal sustainability, reducing unemployment through labour market reforms and making new efforts to enhance growth. It requested Member States to translate these priorities into concrete measures to be included in their Stability or Convergence Programmes and National Reform Programmes.

(5) On 25 March 2011, the European Council also invited the Member States participating in the Euro Plus Pact to present their commitments in time to be included in their Stability or Convergence Programmes and their National Reform Programmes.

(6) On 27 April 2011, Germany submitted its updated Stability Programme covering the period 2011-2015 and on 7 April 2011 its 2011 National Reform Programme. In order to take account of the interlinkages, the two programmes have been assessed at the same time.

(7) The German economy entered the crisis in a relatively solid position. However, the slump in world trade resulted in a collapse of exports and investment in 2009, such that real GDP contracted by an unprecedented 4,7 %. Nevertheless, after a small rise, unemployment has been falling again since late 2009. The resilience of the labour market reflects the beneficial effects of past reforms facilitating a reduction in hours worked and of subsidies for short-time work. The economy has rebounded strongly from the recession, with real GDP rising by 3,6 % in 2010. Exports have largely reversed the massive decline recorded in 2009 and paved the way for a more broad-based recovery also leading to a diminishing current account surplus. The economy has further improved its competitiveness vis-à-vis most of the other euro area Member States. The general government budget went from being in balance to a deficit of 3 % of GDP in 2009, driven by fully operating automatic stabilisers and discretionary measures to counter the economic downturn. The economic recovery helped to contain the deficit in 2010 (3,3 % of GDP) despite ongoing sizeable fiscal stimulus and financial market support measures.

(8) Based on the assessment of the updated Stability Programme pursuant to Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underlying the Stability Programme is cautious for 2011 and plausible thereafter, also as assessed against the Commission services spring 2011 forecast. The Stability Programme projects real GDP to grow by 2,3 % in 2011, before slowing to 1,8 % in 2012 and to an average of 1,5 % in 2013-2015. The Stability Programme plans to bring the deficit below the 3 % GDP reference value already in 2011, two years ahead of the deadline established by the Council, and to make further progress towards achieving the medium-term objective (MTO) – a deficit of 0,5 % of GDP in structural terms – in 2014. Following the expected correction of the excessive deficit, the pace of adjustment towards the MTO under the Stability Programme falls below the 0,5 % of GDP benchmark in 2013 and 2014. While the debt-to-GDP ratio rose by almost 10 percentage points in 2010[1], it is projected to start falling as of 2011 and should reach 75,5 % of GDP by 2015, thus remaining above the Treaty reference value. The risks to the budgetary projection appear broadly balanced for 2011, but the outcomes thereafter could be weaker than expected, since some savings might not materialise as envisaged. Certain measures are still subject to debate (e.g. energy and financial transaction tax) and others remain to be specified (e.g. efficiency improvements in public administration). Moreover, further financial market support measures cannot be excluded. According to the Commission's latest assessment, the risks with regards to long term sustainability of public finances appear to be medium.

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1 The jump in 2010 was largely related to the fact that two troubled banks transferred impaired assets to their respective "bad-banks", which are classified under the government sector. In line with the Eurostat guidance on accounting rules for financial defeasance structures, the corresponding liabilities of "bad-banks" had a direct impact on the debt level.

(9) Since the recent reform of the health-care system introduced measures to curb spending increases mainly in 2011 and 2012, further steps to enhance the efficiency of public spending on health-care and long-term care, would support the envisaged consolidation path. At the same time, maintaining a largely growth-oriented consolidation course, including by ensuring adequate expenditure on education, would help to strengthen the long-term growth potential.

(10) While the German fiscal framework has been considerably strengthened through the introduction of a constitutional budgetary rule, the creation of the Stability Council and the early warning system to prevent budgetary distress, the budgetary rule still needs to be fully implemented at *Länder* level. Further strengthening of the associated monitoring and sanctioning mechanism would also enhance the overall credibility of the public finances.

(11) The crisis revealed serious vulnerabilities in the banking sector. Heavy losses and write-downs from international investments in subprime loans and structured assets weakened the capital base of some banks and led to the need for substantial state interventions. The crisis also exposed the weaknesses of some *Landesbanken*, which had already been suffering from a lack of effective risk management structures and the absence of a viable business model before the crisis. Further reform of the banking sector, including restructuring of the *Landesbanken* in need of a viable and adequately funded business model and strengthening of the regulatory and supervisory framework, would help preserve the stability of the financial sector and also ensure a more efficient allocation of domestic savings as a means of underpinning demand and investment.

(12) The growth potential and structural competitiveness of the German economy depend to a large extent on a well-trained, skilled workforce, but labour supply shortages may become pressing given demographic developments. This underlines the importance of fully utilising the labour force potential by removing obstacles to labour market participation for particular groups (older workers, women, the low-skilled, non-EU nationals) and the further development of human capital. Addressing the tax wedge, which remains high especially for low and middle incomes, would improve incentives to work while allowing wage increases to be translated to a greater extent into higher disposable incomes and domestic demand. The high marginal income tax rate for second earners due to the joint taxation of couples creates disincentives for labour supply. The 'Faktorverfahren' introduced in 2009 allows for the individual monthly tax burden to reflect the personal income of each individual, while the tax burden for the year as a whole remains unchanged. The effects of this reform on labour market participation should be monitored. In this context, further measures to reduce possibly remaining disincentives to work might be necessary. Further increasing the availability of childcare facilities would in particular also help to improve the still low full-time labour force participation of women. Moreover, increasing the number of persons with vocational training qualifications could enhance the labour market prospects of low-skilled workers.

(13) Germany has recently taken far-reaching decisions on its future energy mix. The implementation of the Energy Concept will imply a fundamental transformation in energy supply and have implications for energy prices and the competitiveness of the economy in the medium to long term. Cost-effectiveness should therefore be the key guiding principle for the implementation of the Energy Concept, based on efficient energy consumption, cost-effective support schemes and adequate electricity grids for renewable energy and competitive energy markets.

(14) Boosting competition in the service sector would foster productivity growth and support domestic demand. More dynamic growth of the service sector could also contribute to broadening the base for supply and demand growth in Germany. Despite considerable progress in recent years through the implementation of the Services Directive, there appears to be scope to further reduce barriers to the entry and exit of firms, notably by further simplifying the license and permit system and to simplify the regulation for the exercise of certain professional services. The justification and adequacy of the regulation of certain crafts could be examined. With regard to network industry services, competition in the railway sector in particular can be improved. Strengthening the supervisory role of the Federal Network Agency and the opening of sales and ticket infrastructure to competitors would foster competition in the short run.

(15) Further reforms to improve the accessibility and quality of the education and training system will be key to ensuring an adequately skilled labour supply, also in view of demographic developments. Shortages of medium- and high-skilled labour in particular are forecast, especially as regards mathematics, science and technology subjects. The educational attainment rates of young people in Germany, at both upper secondary and tertiary level, are below the EU average. Increasing the availability of pre-school education and all-day schools and easing the transition between different strands of the school system may improve educational outcomes.

(16) Germany has made a number of commitments under the Euro Plus Pact. On the fiscal side, the commitments call for the excessive deficit to be corrected already in 2011 and for the targets under the national budgetary rule to be achieved by a wide margin in 2011-2012. To reinforce financial stability, measures include efficient regulation and supervision of the capital market. Employment measures focus on labour market participation (reform of active labour market instruments, improved integration of professionals with foreign qualifications and integration of migrants) and education (Basic Education Pact). The competitiveness measures focus on network industries, energy and the service sector (i.e. market transparency agency for the electricity and gas sector, a programme on electromobility, and increased funding of transport infrastructure) as well as on education (i.e. Initiative for Excellence to promote graduate schools and funding of the University Pact). These commitments refer to the four areas of the Pact. They largely reflect the broader reform agenda outlined in the Stability Programme and the National Reform Programme. However, several policy areas remain unaddressed in the Pact commitments (e.g. restructuring of *Landesbanken* or the tax wedge on labour) or are only touched upon (opening the services sector and network industries to greater competition). The Euro Plus Pact commitments have been assessed and taken into account in the recommendations.

(17) The Commission has assessed Germany's Stability Programme and National Reform Programme, including its Euro Plus Pact commitments. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Germany but also their conformity with EU rules and guidance, given the need to reinforce the overall economic governance of the EU by providing EU-level input for future national decisions. In this light, the Commission considers that the German budgetary strategy should be implemented as envisaged. An adequate structural adjustment effort towards the MTO should also be ensured thereafter, while maintaining a growth-friendly consolidation course. Further steps in 2011-2012 should focus on ensuring the stability of the financial system (e.g. through restructuring of the *Landesbanken*), the strengthening of domestic sources for growth, by increasing labour market participation through a reduction of the tax wedge on labour, improving the accessibility and quality of education, and opening up the services sector, trades and professions and the network industries to greater competition.

(18) In light of this assessment, also taking into account the Council Recommendation under Article 126(7) of the Treaty on the Functioning of the European Union of 2 December 2009, the Council has examined the 2011 update of the Stability Programme of Germany and its opinion[1] is reflected in particular in its recommendation (1) below. Taking into account the European Council conclusions of 25 March 2011, the Council has examined the National Reform Programme of Germany,

HEREBY RECOMMENDS that Germany take action within the period 2011-2012 to:

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[1] Foreseen in Article 5(3) of Regulation (EC) No 1466/97.

(1) Implement the budgetary strategy for the year 2012 and beyond as envisaged, thus bringing the high public debt ratio on a downward path, in line with the Council recommendations under the EDP. Ensure an adequate structural adjustment effort towards the medium-term objective thereafter. Complete the implementation of the budgetary rule at the *Länder* level and further strengthen the corresponding monitoring and sanctioning mechanism. Maintain a growth-friendly consolidation course, in particular by safeguarding adequate expenditure on education and by further enhancing the efficiency of public spending on health-care and long-term care.

(2) Address the structural weaknesses in the financial sector, in particular by restructuring *Landesbanken* which are in need of an adequately funded viable business model.

(3) Enhance participation in the labour market by improving equitable access to education and training systems and by taking further steps to reduce the high tax wedge in a budgetary neutral way and improve work incentives for persons with low income perspectives. Increase the number of fulltime childcare facilities and all-day schools. Closely monitor the effects of recent reform measures to reduce tax disincentives for second earners and take further measures in case disincentives remain.

(4) Remove unjustified restrictions on certain professional services and on certain crafts. To improve competition in network industries, strengthen the supervisory role of the Federal Network Agency in the rail sector; and, in the context of the announced national Energy Concept, focus on improving the long-term cost-effectiveness of the Renewable Energy Act, ensuring the effective independence of energy production and transmission, and improving cross-border interconnections.

Done at Brussels,

For the Council
The President