Federal Ministry
of Finance

German
Stability Programme

2012 Update

German
Stability Programme
2012 Update

Contents

Tables

Introduction to the 2012 Update of the German Stability Programme

In accordance with the provisions of the preventive arm of the Stability and Growth Pact, the euro-area Member States draw up annual Stability Programmes and the remaining Member States frame Convergence Programmes which are then submitted to the European Commission and the ECOFIN Council, generally in April of each year.

This update of the German Stability Programme was approved by the Federal Cabinet on 18 April 2012. Its format and contents follow the *Guidelines on the format and content of Stability and Convergence Programmes* (Code of Conduct). The Federal Government submits each update of the German Stability Programme and the corresponding Council Opinion on the updated German Stability Programme to the competent committees of experts of the German Bundestag, the Finance Ministers' Conference (*Finanzministerkonferenz*) and the Stability Council (*Stabilitätsrat*).

The Federal Ministry of Finance (*Bundesministerium der Finanzen*) publishes the updated Stability Programme along with the programmes for preceding years online at:

http://www.bundesfinanzministerium.de

The programmes of all EU Member States, the corresponding European Commission analyses and ECOFIN Council recommendations are published on the European Commission's website at:

http://ec.europa.eu/economy_finance/economic_governance/sgp/convergence/index_en.htm

The tightening of European fiscal rules: an overview

The European Stability and Growth Pact (SGP) provides the framework for the fiscal surveillance of the EU Member States. The SGP was concluded to guarantee the smooth functioning of the European Economic and Monetary Union whilst at the same time observing the Member States' national responsibility for their public finances. However, the European sovereign debt crisis has made it clear that the SGP in its previous form was not able to guarantee fulfilment of that objective. That is why the Eurogroup and the ECOFIN Council have pro-actively driven forward work to optimise procedures, to tighten the SGP and to create a new procedure for monitoring excessive macroeconomic imbalances.

The first step was taken in 2011, when the *European Semester* was introduced to more efficiently coordinate economic, employment and budgetary policy within the EU. The aim is to incorporate the European dimension at an early stage into the debates on which direction public finances are to take the following year. More specifically, the European Semester temporally aligns and combines previously separate budget policy coordination processes under the SGP and structural policies under the EU Growth Strategy ("Europe 2020"). In March each year, the European Council adopts horizontal economic, employment and fiscal policy guidelines which build upon preparatory work done by the European Commission and various Council groupings. In April, the Member States submit their Stability or Convergence Programme and National Reform Programme, both of which take account of these guidelines. Subsequently, the European Commission draws up a first draft of country-specific policy recommendations. These are then discussed in the relevant Council groupings (primarily the ECOFIN Council with regard to the Stability and Convergence Programmes) together with the European Commission; if necessary, they are modified. The final country-specific recommendations are adopted by the ECOFIN and EPSCO Council and approved by the European Council in late June. The Member States must then take account of the country-specific recommendations when drawing up and adopting their budgets.

As well as this process optimisation, the *rules on the Stability and Growth Pact* were markedly tightened by means of six European legal acts (known as the "six-pack"). The preventive aspect was strengthened by placing greater emphasis on the medium-term objective of bringing budgets close to balance, and a binding requirement to reduce the debt ratio was set out in the corrective part of the SGP. Both the deficit and debt ratio reduction processes are now subject to a new graded system of sanctions: In future, sanctions can be imposed earlier on those euro-area Member States which breach the rules and, due to a new, quasi-automatic decision-making process, more easily as well:

- The *preventive arm of the SGP* requires that each Member State set itself a medium-term budgetary objective (MTO) of a structural deficit ceiling of no more than 1 % of gross domestic product (GDP).[1] The MTO in particular aims to guarantee a safety margin with

[1]The structural deficit is the actual deficit adjusted for cyclical and one-off effects. The symmetrical approach to cyclical effects by permitting automatic stabilisers to take effect guarantees that additional room for manoeuvre

respect to the reference value set out under the corrective arm and the achievement of sustainable public budgets. If the structural deficit exceeds the MTO, the country is committed to following an adjustment path towards an annual average reduction of the structural deficit of 0.5 % of GDP. In addition, a new expenditure rule is applied to assess whether an adjustment path is appropriate, according to which expenditure growth (in particular adjusted for interest payments) may not exceed medium-term potential growth. Increases in expenditure which are financed by discretionary revenue measures or which are clearly compensated by statutory increases in revenue (e.g. social security funds) are not classed as breaching the reference value; likewise, a deviation in growth development is classed as immaterial if the Member State has exceeded its MTO and continues to meet it. Where a country deviates significantly from the MTO or adjustment path towards the MTO, the Council may issue recommendations as to how those deviations are to be eliminated within a maximum period of five months. According to the new rules, if no effective measures are taken, sanctions may already be imposed against euro-area Member States at this stage. The Council may block a corresponding recommendation by the European Commission only with a qualified majority (quasi-automatism). This decision to impose sanctions leads to payment of an interest-bearing deposit of 0.2 % of GDP.

- The *corrective arm of the SGP* still takes effect in the event of a breach of the reference value of 3 % of GDP for the deficit ratio. What is new is that the path to reducing the debt ratio has been defined more precisely. Accordingly, a deficit procedure will also be launched when a Member State has a debt ratio in excess of 60 % of GDP, the overrun of the reference value over the past three years was not reduced by at least 1/20 on average p.a. or the European Commission does not forecast any reduction in that amount for the past year and two subsequent years.[2] Account is to be taken, when evaluating adherence to the debt criterion, of the influence of bilateral or multilateral support measures given to EU Member States to guarantee financial stability and stability measures implemented during financial market crises, among other things. Sanctions are already imposed on euro-area Member States when a deficit procedure is launched: An interest-bearing deposit imposed under the preventive arm is translated into a non-interest-bearing deposit. If no effective measures are taken in line with the Council recommendations, a fine in the amount of 0.2 % of GDP may be imposed. Sanctions recommended by the European Commission may also only be rejected by a qualified majority. If, subsequently, no measures are taken, at the end of the deficit procedure the sanctions provided for under primary law may be applied (generally a fine of no more than 0.5 % of GDP).

---

for net borrowing in economic bad times is balanced by the relevant commitments to lower net borrowing or surpluses in economic good times.

[2] This rule does not apply to Member States which were already in deficit procedures in November 2011 until three years after the end of the deficit procedure.

Requirements under the tightened Stability and Growth Pact

Preventive arm	Corrective arm

• **Medium-term budetary objective (MTO) :** structural deficit ceiling of 1% of GDP
• **If not achieved, appropriate adjustment path**
  • **Improvement in structural balance** (reference value: 0.5% of GDP p.a.)
  • **Expenditure rule** (always < medium-term potential growth)
• **Quasi-automatic sanctions**:
  • Can only be rejected by qualified majority
  • Interest-bearing deposit of 0.2% of GDP
	• **Deficit** threshold of 3% of GDP
	• **Debt ratio of** a max. 60% of GDP (average reduction of overrun by 1/20 p.a.)
	• **Quasi-automatic sanctions**:
	  • Can only be rejected by qualified majority
	  • Translation of interest-bearing into non-interest-bearing deposit upon opening of deficit procedure in accordance with Art. 126 (6) of the TFEU (0.2% of GDP)
	  • If no effective measures are taken in accordinace with Art. 126 (8) of the TFEU, translated into a fine (0.2% of GDP)
	• **Further escalation:** Notice of delay in accordance with Art. 126 (9) of the TFEU; sanctions in accordance with Art. 126 (11) of the TFEU (generally a fine of no more than 0.5% of GDP)

The "six-pack" also includes *guidelines on requirements made of Member States' budgetary-policy framework* which aim, among other things, to improve national fiscal policy processes and to create more reliable statistical bases for fiscal surveillance. The minimum standards defined under the guidelines include the commitment to publish monthly cash data at federal and *Länder* level and for social security funds, as well as, on a quarterly basis, corresponding data for local authorities. The Member States are to ensure that realistic macroeconomic forecasts are used in budgetary and medium-term financial planning, and they are to have at their disposal numerical budget rules which guarantee compliance with the requirements set out in the SGP. In addition, Member States are obliged to draw up multi-year budgetary plans.

In addition to the changes which have already been agreed, the Commission has put forward *two further draft regulations* (known as the "two-pack") which, among other things, aim to align budget cycles and to enable fiscal surveillance at European level to be guided even more by the preventive aspect. The draft regulations also provide that in the event of serious breaches of the SGP the European Commission can require that Member States revise their budgets. These regulations are still work in progress.

The *Treaty on Stability, Coordination and Governance in the Economic and Monetary Union* (Fiscal Compact) was signed at the European Council meeting on 2 March 2012. The objective of the Treaty is to place the fiscal stability union on a reliable basis under the national law of the contracting parties. In particular, the Treaty sets out the following:

- Ambitious targets in regard to national limits on public borrowing (annual structural deficit ceiling of 0.5 % of GDP).
- Implementation in national law must be through provisions of binding force and a permanent character, preferably at constitutional level.
- Monitoring by the European Commission of the implementation of the new budget rule in national law within one year after the entry into force of the Treaty. In the event of non-implementation, the European Court of Justice will be invoked by those EU Member States holding the trio presidency. In the event of non-compliance with the European Court of Justice’s decision regarding the non-implementation of budget rules, the Treaty provides for the imposition of a financial sanction of no more than 0.1 % of GDP.
- The opening and all further decisions taken in the context of the deficit procedure will in future occur quasi-automatically following non-compliance with the deficit criterion (reverse qualified majority voting).
- The Treaty provides for close links with the European Stability Mechanism (ESM). In future, those countries wishing to receive assistance under the ESM must have ratified the Treaty by 1 March 2013 and have introduced a national limit on public borrowing within the deadline for transposition.

The heads of state and government of the euro-area Member States and six other EU Member States adopted the *Euro Plus Pact* at the European Council meeting on 24/25 March 2011. Under this Pact the participating Member States have committed to implementing concrete measures to promote competitiveness, employment and financial stability and to contributing to improving the sustainability of public finances, taking account of demographic developments, which must be implemented within 12 months. The participating Member States report on implementation of their voluntary commitments in their National Reform Programmes and in their Stability/Convergence Programmes.

1 Summary

By pursuing the line of fiscal policy presented in this Stability Programme, Germany will fully comply with the fiscal policy requirements at European and national level. Alongside the institutional reforms which are being undertaken (such as tightening the rules under the SGP and signing the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union), Germany is making a major contribution to the stability of the European Economic and Monetary Union through its national fiscal policy as well.

On 2 December 2009, in line with Article 126 of the Treaty on the Functioning of the EU, ECOFIN determined that Germany was running an excessive deficit and called on the country to reduce its deficit by 2013. Against this backdrop and on the basis of the provisions applicable to the new budget rule (known as the “debt brake”), German fiscal policy introduced a sustainable, growth-oriented course of consolidation as soon as the financial market and economic crisis had been overcome.

Germany had already complied with the requirements of the corrective arm of the SGP in regard to net lending/borrowing in 2011 by significantly improving its general government budget balance by 3.3 percentage points to record a general government deficit of 1.0 % of GDP. Germany thus fulfilled last year’s voluntary commitment under the Euro Plus Pact, namely to fall below the 3 % threshold, two years earlier than provided under the excessive deficit procedure. This year’s voluntary commitment provides that, in regard to fiscal policy measures, Germany will already achieve its MTO in 2012 (structural net borrowing of a maximum of 0.5 % of GDP).

The economic development in Germany also shows that consolidation and economic growth go hand in hand, given that the economy generated strong growth for the second consecutive year in 2011. Over the course of the year, GDP exceeded the level seen prior to the crisis. On an annual average, GDP grew by 3.0 % in real terms on the previous year.

Further progress will be made towards balancing public budgets in the programme period to 2016. From this year, Germany will already be able to meet its MTO, given that its structural deficit will stand at a maximum of 0.5 % of GDP. From 2014, both the structural and actual general government budget will be balanced. The debt ratio will drop noticeably from 82 % this year to 73 % in 2016.

2 German fiscal policy in the European context

The requirements made of Germany under the SGP and the fiscal commitments made under the Euro Plus Pact are set out below. By pursuing the line of fiscal policy presented in this Stability Programme, Germany will fully comply with these requirements. Progress which Germany has also made as part of its coordination of the economic and employment policy aspects of the Europe 2020 targets, the 2011 country-specific recommendations and the 2011 Action Programme for the Euro Plus Pact is recorded in the 2012 National Reform Programme, which also contains the new 2012 Action Programme for the Euro Plus Pact. The Federal Cabinet adopted the National Reform Programme on 21 March 2012. The measures with financial impact are simultaneously covered by the fiscal strategy and the projection for public finances which are contained in the Stability Programme.

2.1 Requirements set for Germany under the preventive and corrective arm of the SGP

Under the preventive arm of the SGP and in accordance with the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, Germany has set itself the MTO of achieving a structural deficit of a maximum of 0.5 % of GDP. In view of the new expenditure rule under the preventive arm and according to the relevant calculations by the European Commission, Germany may, in 2012, increase nominal expenditure (adjusted, among other things, by interest payments) by a maximum of 2.7 % upon achieving the MTO.

As well as a maximum deficit of 3 % of GDP, the corrective arm also requires the steady reduction of the debt ratio to the reference value of 60 % of GDP (1/20 rule). Given Germany’s current debt ratio of just over 80 % of GDP, this requirement would result in an average annual reduction over the defined three-year period of around 1 % of GDP. When doing the relevant analysis, account must be taken, among other things, of the influence of bilateral or multilateral support measures given to EU Member States to guarantee financial stability and stability measures in the event of financial market crises. Based on the transitional period set out in the specifications for those Member States which were in deficit procedures at the time of the adoption of the SGP (November 2011), that is also for Germany, the 1/20 rule will apply to Germany from 2015.

On 2 December 2009, in line with Article 126 of the Treaty on the Functioning of the EU, the ECOFIN Council determined that Germany was running an excessive deficit and issued recommendations on reducing this deficit. The recommendations set 2011 as the year in which Germany was to begin consolidation, called for an annual average reduction of the structural deficit of at least 0.5 % of GDP, and required the deficit to be brought below the 3 % of GDP reference value by 2013.

In last year’s country-specific recommendations, the ECOFIN Council on 12 July 2011 in its Opinion on the 2011 German Stability Programme called on Germany to “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."

2.2 This year's horizontal fiscal policy guidelines in the context of the European Semester

At its meeting on 1/2 March 2012 and building on the European Commission's Annual Growth Survey and subsequent ECOFIN Consultations, the European Council made it clear that fiscal consolidation is an essential condition to return to higher growth and employment. All Member States should continue to respect their commitments under the SGP which allow the automatic stabilisers to work around the agreed path of structural fiscal adjustment, while ensuring the long -term sustainability of public finances. Member States that are part of an assistance programme and under pressure from financial markets should meet agreed budgetary targets and, if necessary, stand ready to pursue further consolidation measures. As part of the consolidation strategy, priority is to be given to future investments, in particular in regard to education, research and innovation. The efficiency and effectiveness of the tax system should be reviewed, and it has been suggested that the tax base should be broadened, unjustified exemptions abolished and taxes should be shifted away from labour.

2.3 Voluntary fiscal commitments made by Germany under the Euro Plus Pact

Through the 2011 Action Programme adopted as part of the Euro Plus Pact, Germany committed itself to two fiscal policy objectives to be achieved within the next 12 months: Germany was to fall below the 3 % reference value in 2011 (two years earlier than required under the excessive deficit procedure) and net borrowing in the 2011 and 2012 federal budget was also to be well below the limit provided for under the budget rule. Both targets were achieved.

As regards fiscal measures, the 2012 Action Programme in particular provides that Germany already achieve its MTO under the SGP in 2012 (structural financing deficit of a maximum of 0.5 % of GDP). The Federal Government will also fall below the reduction level set out in the new budget rule ("debt brake") in the 2013 federal budget. By adjusting the income tax rate, additional tax burdens on account of the so-called tax creep (*kalte Progression*) will be reduced in two stages, on 1 January 2013 and on 1 January 2014. The additional tax receipts in the coming years which were forecast by the Working Group on Tax Revenue Forecasting (*Arbeitskreis Steuerschätzungen*) in November 2011 give the government financial room for manoeuvre of €6bn p.a. The adoption of the Act to Strengthen German Financial-Market Supervision (*Gesetz zur Stärkung der deutschen Finanzaufsicht*) aims in particular to improve macroprudential monitoring from 1 January 2013. In order to be able to guarantee financial market stability even in the event of a systemic crisis, the Financial Market Stabilisation Fund (*Finanzmarktstabilisierungsfonds,* SoFFin) will be reactivated on account of the Second Act on the Implementation of a Package of Measures to Stabilise the Financial Market (*2. Finanzmarktstabilisierungsgesetz*) for a limited period until the end of 2012. These and other economic policy commitments in the German Action Programme for the Euro Plus Pact are set out in the 2012 National Reform Programme.

3 Macroeconomic situation and outlook to 2016

3.1 Macroeconomic situation in Germany in 2011

In 2011 the German economy generated strong growth for the second year in a row. Over the course of the year, real GDP again exceeded the level achieved before the crisis. On an annual average real GDP grew by 3.0 % in 2011 on the previous year. The very high rate of expansion of the economy as a whole in the first quarter of 2011 contributed significantly to that development, though it contracted markedly in the second and third quarter. In the final quarter, macroeconomic activity dropped slightly viewed over the period.

In 2011, domestic demand contributed the largest statistical share to overall economic growth (+2.2 percentage points). Private consumption expenditure grew in real terms as substantially as was last the case five years ago (+1.5 %), and both expenditure on plants and machinery and building investments increased strongly year on year. Private consumption in particular benefited from a significant increase in private households' disposable income, to which strong growth in employment and pay rises contributed most. The number of people in employment rose by over half a million, reaching a new high of a total of 41.1 million. At the same time, unemployed figures dropped on a yearly average to their lowest level since 1991. The increase in the level of consumption and the marked increase in expenditure on plants and machinery had a positive effect on domestic demand. Businesses' investment activities benefited from the strong growth in exports, which provided noticeable impetus for economic growth. Price-adjusted exports of goods and services grew by more than 8 %, for instance. Since the import volume increased slightly less (+7.4 %), net exports contributed a positive growth of 0.8 percentage points. Thus, in purely statistical terms, net exports contributed markedly less to the increase in GDP than domestic uses did. The consumer price index rose significantly stronger on the year in 2011, with a yearly average increase of 2.3 %. Price increases were above all influenced by the marked increase in the price of energy products. By contrast, the movement of prices determined by domestic influencing factors (core inflation) remained moderate.

3.2 Short- and medium-term outlook for the economy as a whole

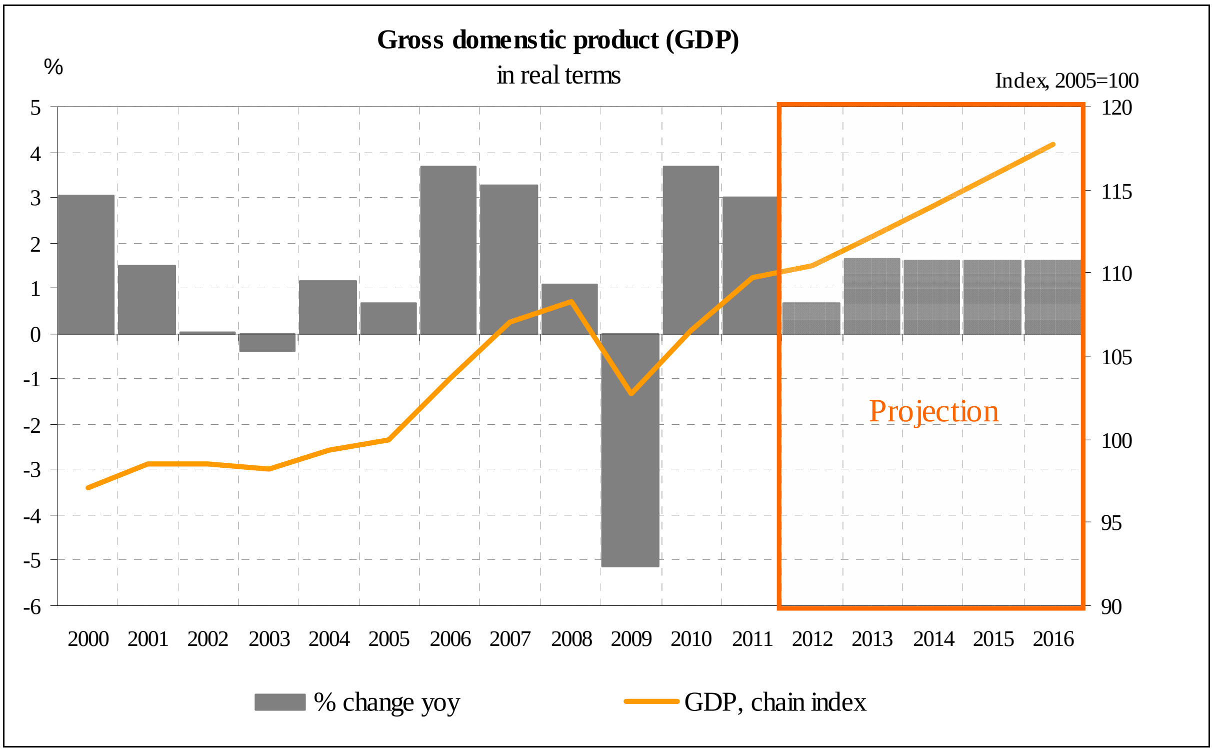
The economy grew at a sluggish pace in the last quarter of 2011, above all in reaction to the global economic slowdown. Indicators are currently pointing to tentative economic recovery in the first quarter of 2012. For instance, leading indicators of market sentiment now suggest that the trend is clearly upwards. Together with developments on the German labour market, which continue to be good, the conditions thus appear to be in place for the economic upswing to continue. In addition, in the course of this year the global economy will likely firm up again, so that the economic drivers in Germany will, in all probability, gain momentum once more. The economic situation outlined by the Federal Government thus concurs qualitatively with that by the European Commission.

In the second half of 2012 the seasonally-adjusted annualised growth rate of GDP will likely approximate to potential growth. On account of the subdued start to 2012 and due to the considerably lower statistical overhang, year-on-year, the annual average increase in real GDP – as predicted in the Federal Government's annual projection – will, at 0.7 %, probably be significantly lower than last year.

In 2012, forces of growth will again continue to shift towards domestic demand. In particular, weaker overall economic activity in the euro zone, where around 40 % of German exports go to, is having a noticeably negative impact on German businesses' export activities. As a consequence, real goods exports will likely increase only moderately this year (+2.0 %). In the course of increasing domestic demand, the volume of imports is expected to increase by 3.0 % on average. This leads to net exports contributing negatively, in statistical terms, to overall economic growth (-0.3 percentage points). By contrast, domestic uses will likely contribute 1.1 percentage points to growth.

The less favourable global economic climate and the resulting drop in turnover generated abroad by German businesses will likely also dampen investment activity. It is therefore expected that the volume of expenditure on plants and machinery will increase only moderately in 2012 on a yearly average (+2.0 %) – after catching up strongly over the past two years. Developments as regards building investments will be muted this year due to a loss in momentum in public building activity (+0.8 % in real terms, after +5.8 % in 2011). However, developments will be supported by commercial building and housing construction.

Private consumption will, by contrast, gain a significant role when it comes to boosting growth in the course of the economic cycle. For instance, consumer spending will increase by 1.2 % in real terms. Given the significant increase in private households' disposable income (+3.0 %) – assisted by positive developments on the labour market and pay rises – conditions are favourable for a further expansion of private consumption. The number of those in gainful employment is set to increase by around 220,000 to 41.3 million in 2012 on a yearly average. This will be accompanied by a drop in the number of registered unemployed by around 100,000 to approx. 2.9 million. The expected gradual relaxation of the price climate will likely have a favourable impact on households' purchasing power and thus on their consumption patterns this year. An increase in the consumer price level on a yearly average of 1.8 % is expected. Nevertheless, the price of crude oil on the global market recently rose sharply, which means that the assumption of US$109 per barrel on which the consumer price projection is based will clearly be exceeded. This represents a risk to the trend in the price level.



Thanks to the strong growth experienced over the past two years, the German economy has reached its pre-crisis level. Nevertheless, GDP will initially stay below the production potential, which predicts a normal cyclical situation. There is, thus, a negative output gap, which will gradually narrow over the course of the medium-term period to 2016. In the period 2013 to 2016 GDP growth in the Federal Government's most recent medium-term projection will increase by just over 1 ½ % p.a., a little more than potential growth, which is estimated at just under 1 ½ % p.a. The increase in overall economic production potential will likely weaken slightly towards the end of the projection period – among other things on account of a drop in the potentially economically active population on account of demographic changes.

The favourable trend on the labour market will continue. Unemployment figures will probably drop to around 2.6 million by 2016. Growth will be supported by domestic demand in the medium-term forecast period. In real terms a yearly average growth in exports of 4 ½ % is expected. However, on account of strong domestic demand, imports will rise slightly more strongly, so that net exports are not expected to contribute, purely statistically speaking, to growth. The increase in domestic uses will above all be marked by buoyant consumer demand and a positive investment trend. Price developments are expected to remain moderate.

4 Fiscal policy in Germany

Sound public finances are a key condition when it comes to building confidence in a state's capacity to act and in regard to permanently favourable growth and employment conditions. But this is not a one-way street: Economic growth and increased employment create the best conditions for sustainable public finances. Quantitative and qualitative consolidation complement each other because the existence of public budgets which are built on sound finances is a decisive precondition for being able to place increased emphasis on future-oriented policy areas.

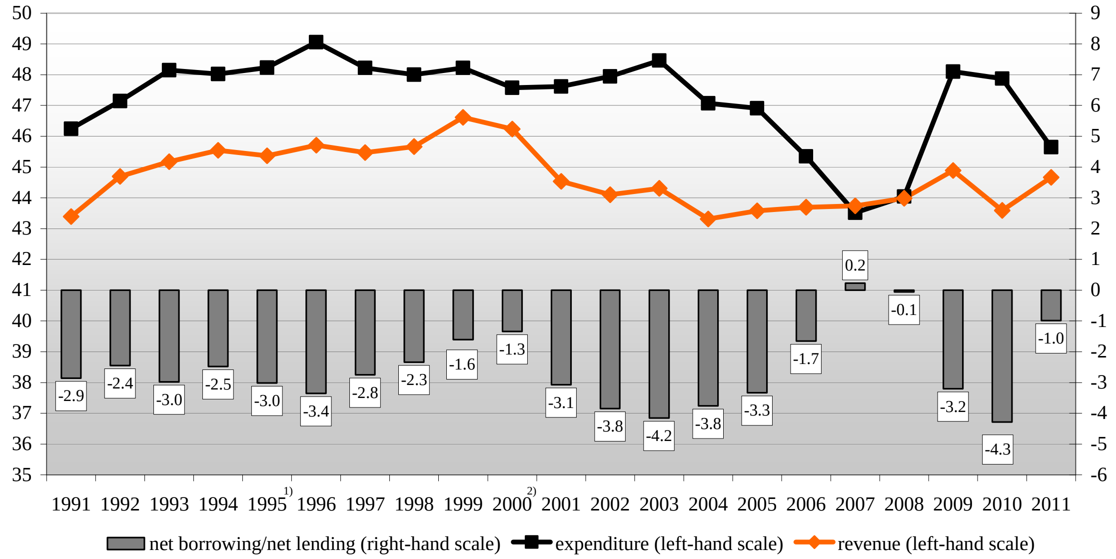
4.1 Fiscal situation and strategic direction

Public finances in Germany were gravely affected by the financial and economic crisis as well as government stabilisation measures. After public finances were practically balanced in 2007 and 2008, Germany's general government budget balance worsened to post a deficit of 3.2 % and 4.3 % of GDP in 2009 and 2010, respectively. The level of debt also increased considerably to 83.0 % of GDP in 2010, in particular on account of financial market stabilisation measures and measures to support EU Member States.

Against this backdrop and on account of the provisions concerning the new German budget rule (known as the "debt brake") and European requirements, German fiscal policy started out on a sustainable, growth-oriented course of consolidation as soon as the financial market and economic crisis had come to an end. Given the significant improvement in net lending/borrowing by 3.3 percentage points to a general government deficit of 1.0 % of GDP, Germany already fulfilled the requirements under the corrective arm of the SGP in regard to net lending/borrowing in 2011. Germany thus met last year's voluntary commitment under the Euro Plus Pact because it fell below the 3 % reference value for the general government deficit ratio two years earlier than required under the deficit procedure. Likewise, net borrowing in the 2011 federal budget of €17.3bn meant that the reduction level set by the new budget rule was clearly exceeded and thus the second voluntary financial policy commitment under the Pact was met. The course of consolidation also had a noticeable effect on the debt ratio, which dropped to 81.2 % in 2011.

General government revenue, expenditure and budget balance

- in % of GDP -



1) Excluding capital transfers as a result of taking on the debts of the Treuhand agency and the housing authorities of the GDR. Including this effect, the general government deficit stood at 9.5% of GDP.

2) Excluding revenue from UMTS licences. Including this effect, the government budget ran a surplus of 1.1% of GDP.

By pursuing the line of fiscal policy presented in this Stability Programme, Germany will fully comply with the European requirements (as detailed in chapter 2). The structural deficit will (as set out in the projection in chapter 5) this year correspond to the MTO set out in the preventive arm of the SGP.

4.2 Institutional framework conditions

The institutional framework conditions are a key factor for sustainable public budgets and the high quality of public finances. Fiscal rules are the classic instrument which governments use in their endeavour to guarantee long-lasting, sound financial action and to efficiently organise the budget process. Within the EU, account is taken of these objectives by applying the mentioned instruments of fiscal and economic policy coordination. The new requirements made of the national budget framework are, not least, also intended to guarantee a better level of fiscal surveillance of Member States at EU level.

Back in 2011 a peer review of national fiscal rules was agreed and carried out. As a consequence of the analyses conducted as part of the peer review process it was found that Germany’s new budget rule (the “debt brake”) was an effective means of strengthening Germany’s fiscal framework to effectively limit deficits. It was suggested in the context of the peer review to further strengthen the monitoring and enforcement of the debt brake at state level, in particular by ensuring consistent rules and provisions for their implementation across all *Länder*, adequate monitoring procedures and effective sanctions in case of non-compliance..

Germany has high-quality fiscal rules applicable at federal and *Länder* level which correspond to EU-level requirements, not least on account of the new budget rule which was enshrined in the constitution, the Basic Law, in 2009. The budget rules applicable at federal and *Länder* level and the narrow borrowing limits set for local authorities and social security funds will in future guarantee achievement of the MTO and thus compliance with the preventive arm of the SGP.

In light of the grave impact of the financial and economic crisis on the budgetary situation, transitional provisions lasting up to and including 2015 (in the case of the Federation) and 2019 (in the case of the *Länder*) were agreed when the budget rule was introduced. The Federation is required to reduce the 2010 structural deficit in equal steps, i.e. by around 0.3 % of GDP annually, to the 0.35 % of GDP ceiling applicable from 2016. The budget rule's symmetrical treatment of cyclical impacts ensures that a cyclically-induced easing of the pressure on the budget is not used for extra structural spending or a structural fall in revenue, but it does mean that a purely cyclical deterioration in the budget situation can be accepted.

As of 2012, the federal budget is being drawn up using a top-down approach in order to better accommodate the requirements of the budget rule. The Federal Cabinet approved the key figures for the 2013 federal budget and financial plan up to 2016 on 21 March 2012. This forms the binding basis for the government's further internal budget drafting procedure, which will conclude in late June 2012 when the Federal Cabinet adopts the government's draft 2013 federal budget and the financial plan to 2016. In the course of the government's further internal procedure account will be taken of more up-to-date forecasts – in particular based on the Federal Government's spring projection on medium-term overall economic development, the pension forecast in late April 2012 and the results of the meeting of the Working Group on Tax Revenue Forecasting on 8 to 10 May 2012.

In future, it will no longer be permissible for the individual *Länder* to take up any new (structural) borrowings. In the transitional period up to 2019 the *Länder* may, in accordance with the applicable regulations under *Land* law, deviate from this requirement under the Basic Law. However, pursuant to the transitional rule set out in the Basic Law, they must draw up their budgets so as to achieve a balanced structural budget in 2020. On account of their particularly difficult budget situation, five of the 16 German *Länder* will receive budget consolidation assistance amounting to a total of €800m annually, which will be funded in equal part by the Federation and the remaining *Länder*. To that end they must clear the structural deficits recorded in 2010 in equal steps by 2020.

The *Länder* are themselves responsible for shaping the finer points of the new budget rule at *Länder* level – within the framework set by the Basic Law as regards the possibility of taking account of cyclical impacts and possible exemptions. However, the ban on new borrowings enshrined in the Basic Law is directly binding on the *Länder*, which means that even if a *Land* has no specific regulations under *Land* law, the ban on new borrowings will apply without exception from 2020.

As well as amending the budget rule, in the course of the reform of the federal structure of Germany a second institutional basis was created for ensuring the long-term sustainability of the federal and *Länder* budgets, namely the Stability Council (*Stabilitätsrat*), which is also enshrined in the Basic Law. The Federal Minister of Finance, the *Länder* finance ministers and the Federal Minister of Economics are members of the Stability Council. The key task of the Stability Council is to regularly monitor the development of the budgets of the Federation and of the *Länder* and to agree budget rehabilitation measures with the relevant levels of government threatened with an impending budget emergency so as to avert the impending emergency and steer their budgets towards sustainable recovery (as set out in detail in the 2011 Update of the German Stability Programme). In addition, the Stability Council will annually (for the first time in May 2012) monitor compliance with deficit ceilings agreed with the five *Länder* receiving budget consolidation assistance, and will take a decision on that basis as to whether the consolidation aid will be granted. Further, the Stability Council is responsible for coordinating budgetary and financial plans at federal level, not least with a view to compliance with commitments made at EU level.

The Stability Council took up its work in 2010 and has since agreed budget rehabilitation programmes with Berlin, Bremen, Saarland and Schleswig-Holstein, compliance with which it monitors on a continuous basis. The budget rehabilitation procedures require that these *Länder,* which are also receiving budget consolidation assistance, submit ex-post proof of the agreed deficit reduction as well as ex-ante evidence of which measures they are applying to reduce their deficits.

4.3 Key fiscal policy measures

On account of its growth-oriented consolidation strategy, the Federal Government is making better progress on the road towards balanced and future-proof budgets than was foreseeable when the 2011 Stability Programme was submitted. The key fiscal bases were already laid in 2010 and 2011 (for details, see the 2010 and 2011 Stability Programmes). Central to that was the decision concerning the budget consolidation package (called the *Zukunftspaket*) which put in place the conditions for the Federation to comply with the new budget rule which entered into force in 2011. Since the decision was taken on the budget consolidation package, additional burdens have also been placed on the budget – in particular as a consequence of the turnaround in Germany's energy policy and Germany's contribution to the ESM. In view of the easing of the budget burden in other ways, the Federal Government has consciously taken the decision to lower its sights in regard to the budget consolidation package and not to offset it by implementing new measures. That applies, for instance, to the burdens on the budget resulting from the fall in receipts from the nuclear fuel rod tax and delays in introducing a tax on financial transactions. However, easing the pressure in other areas ensures that the consolidation targets will still be achieved. The aim of the budget consolidation package was to ensure compliance with the rules of the SGP and to create the conditions for full and permanent compliance, from 2016, with the budget rule enshrined in the constitution. This target will be achieved and the budget consolidation package is contributing to that.

The *Länder* also made progress towards balancing their budgets in 2011. They used positive developments in regard to tax receipts to significantly reduce their funding deficit and plan to continue the course of consolidation they embarked on in 2012. The *Länder* are committed to achieving their objective of a sustainable budgetary policy and are endeavouring to comply with the constitutional "debt brake" by 2020 at the latest.

At the end of 2011 the Special Investment and Redemption Fund (*Investitions- und Tilgungsfonds*, ITF) reached the end of its active term for financing additional investments made in the context of combating the financial market and economic crisis, as provided for. No more funds will thus be paid out. The Federal Ministry of Finance will be submitting a concluding report on the activities of the ITF to the Budget Committee of the German Bundestag.

In 2010 the Federal Government set up an Energy and Climate Fund (*Energie- und Klimafonds,* EKF) to finance additional activities linked to implementation of its Energy Strategy. Further, in summer 2011 a wide-ranging package of legal measures for shaping energy policy was adopted on account of the planned phase-out of nuclear energy. It is intended that in future renewable energies will make up the lion's share of energy supply. The package puts the EKF on a new footing. On the income side, from 2012 all proceeds from the auctioning of greenhouse gas emissions allowances will go to the EKF. In return, from 2012 the EKF will be used to finance additional federal measures to implement the Energy Strategy. The focus will be on measures to boost energy efficiency and to expand the use of renewable energies.

In order to be able to guarantee financial market stability even in the event of a systemic crisis, as announced in the 2012 Action Programme for the Euro Plus Pact, the Financial Market Stabilisation Fund (SoFFin) is being reactivated on the basis of the Second Act on the Implementation of a Package of Measures to Stabilise the Financial Market for a limited period until the end of 2012. Opening up SoFFin for new applications will head off the possible threat to the financial system, in particular in the event that private-sector solutions to strengthen institutions' equity bases fail to be effective. To that end the authorities responsible for financial oversight will be given greater scope for action. The reactivated SoFFin can provide refinancing guarantees of up to a total of €400bn and direct financial assistance of up to a total of €80bn.

Despite additional burdens on the budgets and considerable risks to budgets on account of the difficult European and global economic situation, the Federal Government will continue the course of consolidation set out in the applicable financial plan. This contributes to the continuous reduction of the general government expenditure ratio. Based on the key figures set out in the government's draft of the 2013 federal budget and the financial plan to 2016 the

Federal Government will each year fall well below the net borrowing limit permissible under the new budget rule.

Several consolidation measures applicable to social security funds are contributing to this development: As regards labour market policy the financial relations between the Federation and the Federal Employment Agency (*Bundesagentur für Arbeit*) are being uncoupled to some extent. In future, the Federation will no longer pay a share towards job promotion costs; in return, it will waive its right to the integration contribution (*Eingliederungsbeitrag*) from the Federal Employment Agency. Federal funding towards the statutory pension insurance scheme will be reduced by some €0.75bn in 2013 and by around €1bn p.a. from 2014 to 2016 compared to the development which would result if the consolidation measure were not implemented. The federal grant towards the statutory health insurance scheme will be reduced – once only – by €2bn to €12bn in 2013. This is a legitimate measure because the statutory health insurance scheme does not require the funding provided by the Federation in 2011 for its financial consolidation due to the favourable development of revenue as a result of the current economic climate.

On the expenditure side, the Federal Government still sets targeted priorities in the context of its growth-oriented course of consolidation. It has made available more than an additional €12bn to education and research during the current legislative term. The key points of the financial plan to 2016 provide that the current high level of funding will continue in the period 2014 to 2016. At the same time this represents the Federation's contribution to increasing the R&D ratio to 3 % of GDP. The *Länder* and private actors are also contributing to this.

The share of investment expenditure in the federal budget will be further increased. To strengthen the transport infrastructure the Federal Government has adopted an infrastructure acceleration programme for federal transport routes and endowed it with a total of €1bn for the period 2012 to 2016. Along with cash funds in excess of €500m for 2012, the 2012 budget also provides for additional authorisations amounting to €500m.

Germany's commitments as part of the comprehensive package of measures to stabilise the euro zone are covered by its fiscal strategy. For example, the ESM will provide euro-area Member States which are in financial difficulties with financial assistance under strict economic policy conditions insofar as this is essential to guarantee the stability of the euro zone as a whole; the ESM was established by Treaty of 2 February 2012. Once national ratification procedures have been completed it will enter into force in July 2012 – one year earlier than originally planned. Germany's contribution to the ESM is based on an ECB key. It will contribute a total of around €21.7bn in capital, divided across five tranches, two of which will be paid in 2012. The relevant authorisations under budget law for this early payment are established in the 2012 supplementary budget, the draft of which the Federal Cabinet adopted on 21 March 2012. Germany's share of the callable capital in the ESM totals around €168bn and is made available in the form of federal guarantees.

A growth-friendly fiscal policy also requires that citizens and businesses be left with more of what they have earned. That is why the Federal Government on 7 December 2011 adopted a draft law to reduce, in two stages (1 January 2013 and 1 January 2014), additional tax burdens totalling around €6bn which are incurred on account of the so-called tax creep. The bill rightly provides for the income tax rate to be amended. The amendment, which is intended to take effect in 2013 and 2014, does not change the existing structure of progressive income tax rates, but it does ensure that increasing income in line with inflation does not lead to an increase in the average tax burden. The aim is to introduce more equitable taxation by compensating for the hidden tax increases which result from the tax creep. Regular reviews of the impact of the tax creep across the tax scale are to be conducted every two years, beginning in the 18th legislative term.

The 2011 Act to Simplify Taxation (*Steuervereinfachungsgesetz*) of 1 November 2011 contains measures which relieve the burden on taxpayers and the tax administration in regard to tax declarations submitted and examinations conducted as part of the tax procedure. In addition, creating more planning reliability in the tax procedure is intended to make practical application easier for all those concerned and to reduce superfluous red tape in a targeted fashion. The measures to relieve the tax burden to the tune of a total of around €585m p.a. will benefit employees and families with children. Businesses and citizens will both notice the drop in costs due to the cutting of red tape.

The Third Act to Amend the Turnover Tax Act (*3. Gesetz zur Änderung des Umsatzsteuergesetzes*) of 6 December 2011 revoked the time-limit imposed on the turnover threshold for the cash receipts basis of accounting, which originally ran until 31 December 2011. As a result of the removal of the time-limit and the related permanent national turnover threshold of €500,000, businesses gain more planning reliability and can benefit from an improvement to their cash flow.

5 General government budgetary prospects

Public finances[3] are developing much more favourably than was projected even in last year's Stability Programme. This is due to the much more favourable starting position – even on a structural level – given the general government deficit of only 1.0 % of GDP in 2011. Germany will this year already be able meet its MTO – as set out in this Stability Programme – of a structural deficit ratio of a maximum of 0.5 %. The debt ratio, which has risen sharply since 2008 as a result of the stabilisation measures implemented as part of the financial market and European sovereign debt crisis, will drop noticeably by the end of the programme horizon in 2016.

[3] Unless stated otherwise, all figures according to the system of national accounts (Maastricht definition).

5.1 *Development of general government revenue and expenditure*

Stable development of general government revenue

Over the past few years the development of government revenue and expenditure was strongly influenced by the financial market and economic crisis. Government revenue rose considerably last year (+6.3 %) on the previous year, although that increase is put into perspective given that the two previous years were extremely weak and revenue fell by a total of 0.8 %. The trend will normalise again up to 2016 to an annual average growth of just under 3 % – corresponding to the average growth rate observed over the past 20 years. At a nominal GDP increase of 3 % p.a., government revenue will level out at around 44 ½ % of GDP (Table 1).

Taxes will contribute just over half of government revenue in the projection period. The rise in the tax revenue ratio, i.e. the tax-to-GDP ratio, to 23 ½ % this year is essentially due to the current favourable labour market situation and the increasing contribution private consumption is making to overall economic growth as a result. Further, on the one hand, the one-off effects observed last year on account of court decisions, the effects of which must be entered fully in the national accounts in the year the decision was issued, no longer apply; on the other hand, the proceeds from auctioning CO_2 emissions certificates are added to tax revenue.

The social contribution ratio will drop from 16.9 % last year to 16 ½ % in 2013. The reductions in the rate of contribution to the statutory pension scheme are one factor: On account of the development of the sustainability reserve (*Nachhaltigkeitsrücklage*), the rate of contribution will drop from 19.9 % in 2011 to 19.6 % this year and – according to the underlying assumptions – to 19.2 % in 2013. The slight increase in the rate of contribution to long-term care insurance of 1/10 percentage point to 2.05 % in 2013 is thus more than compensated for. Given the aforementioned developments in regard to the tax ratio and social contribution ratio, the combined tax and social contribution ratio will be around 40 % in the projection period.

Table 1: Development of the general government revenue ratio

	2011	**2012**	**2013**	**2014**	**2015**	**2016**
	- % of GDP -					
Taxes	**22.9**	**23 1/2**	**23 1/2**	**23 1/2**	**23 1/2**	**23 1/2**
Social contributions	**16.9**	**17**	**16 1/2**	**16 1/2**	**16 1/2**	**16 1/2**
Taxes & social contributions	**39.8**	**40**	**40**	**40**	**40**	**40**
Total revenue						
April 2012 Update	**44.7**	**45**	**44 1/2**	**44 1/2**	**44 1/2**	**44 1/2**
April 2011 Update	43	43	43	42 1/2	42 1/2	-

Discrepancies between the combined tax and social contribution ratio and the sum of the tax ratio and the social contribution ratio are the result of rounding. The figures for the projection years are rounded to a half a percentage point of GDP.

Consolidation leads to reduction in general government expenditure ratio

General government expenditure dropped by 1.0 % last year, whereby the development is underlined by the loss of one-off effects in connection with the establishment of the winding-up agencies of the WestLB bank (First Winding-up Agency, EAA) and of Hypo Real Estate (HRE) (FMS Wertmanagement, FMS-WM) which are classified in the government sector.[4] As a result, the composition and development of types of expenditure (and types of revenue) are distorted. Given the large portfolios, interest expenditure and interest income rose considerably without, however, having any noteworthy impact on the general government budget balance.

General government expenditure will increase by around 2 % p.a. on average in the projection period. This year, the increase in expenditure – adjusted for interest payments, for spending on EU programmes which are fully balanced by income from EU funds and for non-discretionary changes to unemployment benefit spending – will also be around 2 % and thus will be well below the relevant reference value of 2.7 % set out in the preventive arm of the SGP for Germany. Government consumption expenditure will increase above the average at around 3 % p.a. on average, essentially on account of the clear rise in social benefits in kind in the statutory health insurance system. Due to continuous improvements in the labour market situation, social benefits other than social transfers in kind will increase only below the average by just under 2 % p.a. on average. The same applies to gross investments, whose development in the period 2009 to 2011 was influenced positively by measures implemented as part of the economic stimulus packages; this development will normalise again in the projection period due to these measures coming to an end. The credible policy of consolidation is reflected in the form of stability dividends, namely low interest rates. In the period 2011 to 2016 interest expenditure will rise by around 3 % on average per annum and will thus be well below what was forecast in the last Stability Programme.

In the medium term the moderate development of expenditure will lead to a drop in the government expenditure ratio; government expenditure in relation to GDP is projected to stand at around 44 ½ % by the end of the projection horizon (Table 2).

Table 2: Development of the general government expenditure ratio

	2011	**2012**	**2013**	**2014**	**2015**	**2016**
	- % of GDP -					
April 2012 Update	**45.7**	**46**	**45 1/2**	**44 1/2**	**44 1/2**	**44 1/2**
April 2011 Update	45 1/2	44 1/2	44	43 1/2	43	-

Figures are rounded to half a percentage point of GDP.

[4] The discrepancies between the transfer value of the portfolio and its market value were recorded as a (fictitious) capital transfer increasing the deficit. No actual payments were linked to these recordings.

5.2 Development of net lending/borrowing

Steady reduction of deficit to a budget close to balance from 2014

The stable general government revenue position and the reduction in the general government expenditure ratio are causing a steady improvement in net lending/borrowing. The general government budget is already likely to be balanced in 2014 and will achieve a “black zero” in the subsequent two years (Table 3).

Table 3: Development of the general government budget balance

	2011	2012	2013	2014	2015	2016
	- in % of GDP -					
April 2012 Update	**-1.0**	**-1**	**- 1/2**	**-0**	**0**	**0**
April 2011 Update	-3.3	-2 1/2	-1 1/2	-1	- 1/2	- 1/2

Figures are rounded to half a per cent of GDP.

Net lending/borrowing by level of government

Last year all levels of government contributed to reducing the general government deficit ratio on account of the positive developments in regard to their budgets, some of them quite considerable. Despite significantly more favourable balances, the Federation and *Länder* still ran a deficit, whilst local governments and in particular the social security funds ran surpluses (Table 4).

Table 4: Net lending/borrowing by level of government

	2011	2012	2013	2014	2015	2016
	- in % of GDP -					
Central government	-1.0	-1	- 1/2	- 1/2	-0	-0
State government	-0.6	- 1/2	- 1/2	- 1/2	-0	-0
Local government	0.0	0	1/2	1/2	1/2	1/2
Social security funds	0.6	1/2	0	0	0	0
General government	-1.0	-1	- 1/2	-0	0	0

The net lending/borrowing figures are rounded to half a per cent of GDP.

The different levels of government will contribute to the balancing of budgets in the medium term by continuing their policy of consolidation across the entire projection period. Strict compliance with the budget rule introduced last year is also playing a decisive role as regards improvements at federal level. For example, the federal core budget will in 2014 already fall below the regular ceiling of the debt brake for structural net borrowing of 0.35 % of GDP, although this is not set to become applicable until 2016. The Federation’s extra-budgetary entities will again run a surplus from 2012. Last year they had still been in deficit on account of the stimulus package and related payments by the ITF. Whilst the *Länder* are slowly reducing their deficits, local governments as a whole will be able to post surpluses from 2012. The increased funds which will be available as a result provide the opportunity both to wipe off debts as well as to finance additional expenditure.

Developments in the social security funds vary, depending on the line of insurance; however, these developments will guarantee a balanced budget or surpluses across the entire projection period. The high surplus achieved last year was essentially a result of the good development in regard to contributions and, at the same time, the moderate increase in expenditure by the statutory health insurance system. This year the loss of the one-off additional federal grant and next year the one-off reduction in the regular federal grant will have a negative impact on the revenue side. In the medium term, expenditure will again increase more steeply, so that, at a constant rate of contribution, the statutory health insurance system will run a deficit (which can be financed by using up assets) from next year. The statutory pension scheme was also able to generate a clear surplus in 2011 and thus to further expand its sustainability reserve. The rate of contribution will be reduced once more next year – despite a reduction in the federal grant. From next year the Federal Employment Agency will no longer receive a federal grant; in return, however, it will no longer be obliged to pay the integration contribution to the Federation. At the same time, more savings will be made on the expenditure side, so that in the medium term it will be possible to increase the surplus again.

5.3 Development of structural net lending/borrowing

MTO will be achieved this year

Almost half of last year's improvement in the general government budget balance of 3.3 percentage points to -1.0 % of GDP (1½ percentage points) had structural origins. More than 1 percentage point was due to the loss of one-off effects, mainly in connection with the winding-up agencies. Just under 1 percentage point can be attributed to economic recovery. Given the weaker GDP growth this year, the output gap is widening again slightly. As currently no one-off effects are foreseeable, further structural improvements will be made this year. Germany will already fulfil its MTO of a structural deficit of a maximum of 0.5 % of GDP in 2012 (Table 5). Structural net lending/borrowing will steadily improve over the coming years; from 2014 both the actual and the structural balance will be balanced.

Table 5: Structural balance compared with actual balance and GDP trend

	2011	2012	2013	2014	2015	2016
Structural balance (% of GDP)	-0.7	- 1/2	- 1/2	0	0	0
General government net borrowing/ net lending (% of GDP)	-1.0	-1	- 1/2	-0	0	0
Real GDP (% change yoy)	3.0	0.7	1.6	1.6	1.6	1.6

Fiscal balances are rounded to half a per cent of GDP.

5.4 *Sensitivity of net lending/borrowing forecast*

The sensitivity analysis indicates the net lending/borrowing developments that arise when changes are made to macroeconomic assumptions. The sensitivity analysis looks at two alternative scenarios which result from a reduction and an increase, respectively, in the annual growth rate of real GDP of half a percentage point per annum from 2012 to 2016. It is assumed that the GDP deflator and GDP composition are constant compared with the baseline scenario.

Should GDP growth only amount to 2 ½ % in nominal terms p.a., the actual balance will not worsen, but it will only improve slowly and hardly noticeably (Table 6). The general government budget balance would then still be -1 % in relation to GDP at the end of the programme period. If, by contrast, GDP were to develop at a yearly rate which is half a percentage point more favourable than assumed in the baseline scenario, this would lead to a balanced budget and in consequence to a clear surplus in 2013 which, by the end of the projection horizon would, amount to 1 ½ % of GDP.

Table 6: Sensitivity of the projection for the general government budget balance

	2011	2012	2013	2014	2015	2016
GDP as in	**- general government budget balance in % of GDP -**					
- baseline scenario	-1.0	-1	- 1/2	-0	0	0
- alternative scenarios						
• - ½ pp p.a. compared to baseline		-1	-1	-1	-1	-1
• + ½ pp p.a. compared to baseline		- 1/2	-0	1/2	1	1 1/2

The net lending/borrowing figures are rounded to half a per cent of GDP.

5.5 *Development of debt*

The development of the debt ratio as defined by the Maastricht Treaty is currently being influenced by two opposite effects. On the one hand, measures implemented during the European sovereign debt crisis are leading to an increase in the debt ratio; on the other hand, we are seeing a reduction in the general government debt ratio on account of the consolidation of public finances and a sound macroeconomic development, but also as a result of the reduction in government support to the banking sector and the winding up of the winding-up agencies’ portfolios. Last year, effects which led to a reduction in the debt ratio predominated: The debt ratio dropped by 1.8 percentage points to 81.2 %. This year, by contrast, the ratio will increase to around 82 % on account of the additional measures taken in the context of the European sovereign debt crisis. The impact of the second aid package for Greece, payments made to ongoing European Financial Stability Fund (EFSF) programmes for Ireland and Portugal, as well as payments to the ESM will lead to an increase in the 2012 debt ratio, taken by itself, of 1.8 percentage points. In the medium term, however, the positive effects of the fiscal policy will predominate, so that the debt ratio will again drop successively from 2013 until 2016 to around 73 %.

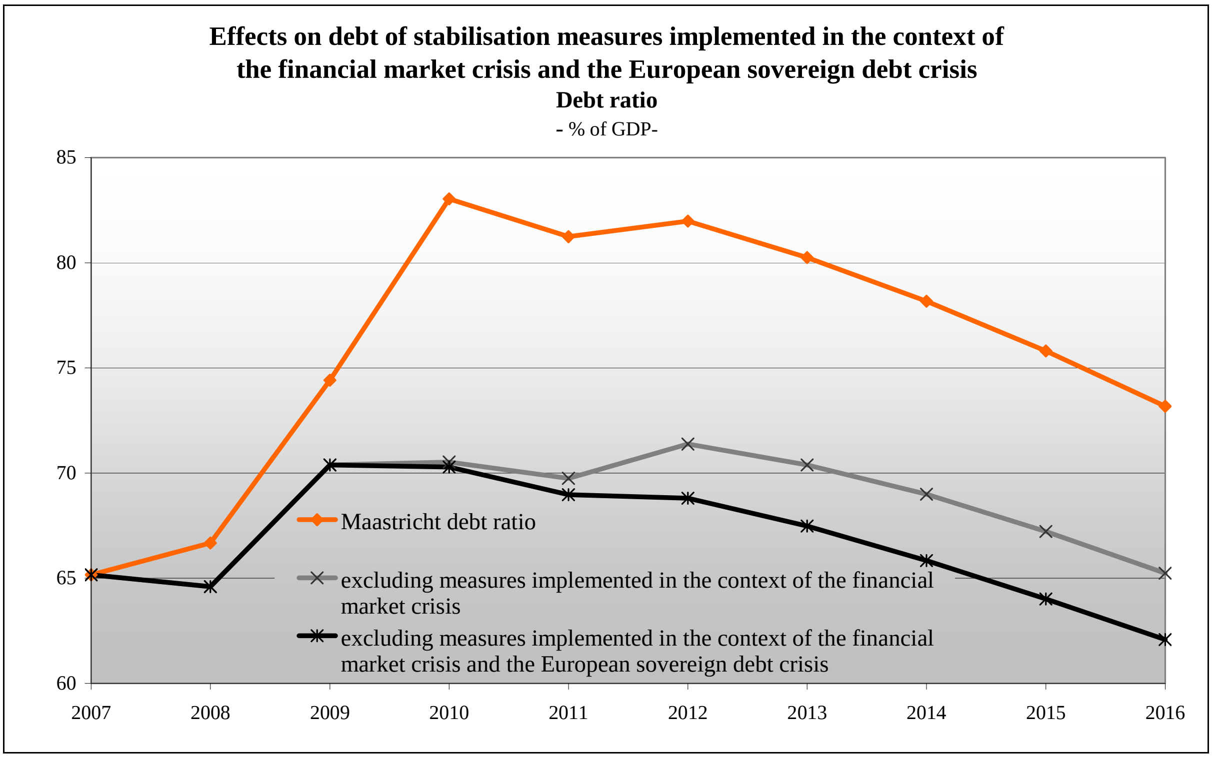
No account is yet being taken in this projection of additional effects on the debt ratio which may arise from a possible transfer of a second portfolio from WestLB to the First Winding-Up Agency in summer 2012, since these can currently not be quantified.

Table 7: Development of the debt ratio

	2011	2012	2013	2014	2015	2016
	- in % of GDP -					
April 2012 Update	**81.2**	**82**	**80**	**78**	**76**	**73**
April 2011 Update	82	81	79 1/2	77 1/2	75 1/2	-

The debt ratios are rounded to half a per cent.

The following graph shows the development of the debt ratio adjusted for the effects of the measures taken in connection with the financial market and European sovereign debt crisis. The development of public budgets, taken by itself, reveals a reduction in the debt ratio across the board since 2010 on account of the stimulus packages coming to an end and the consolidation strategy embarked upon. Whilst in 2009 and 2010 the support measures implemented in the context of the financial market crisis had a decisive influence on the rise in the debt ratio, the increase in 2012 is solely down to measures taken in connection with the European sovereign debt crisis.



6 The long-term sustainability of public finances

6.1 Challenges to the sustainability of public finances

The Federal Government attaches great importance to having sound public finances. The financial and economic crisis as well as the debt problems within the EU have led to a marked increase in the debt ratio in nearly all EU Member States and have made it more difficult to guarantee the long-term sustainability of public finances. In addition, the long-term sustainability of public finances is still decisively dependent on demographic developments.

Germany is facing specific challenges in the face of demographic change: The old-age dependency ratio (the ratio between the pensionable-age and the working-age population) will increase significantly in Germany up to 2060. Pursuant to population projections by Eurostat, the EU's statistical office, and by the Federal Statistical Office (*Statistisches Bundesamt*), it will increase from just over 30 % in 2010 to around double that figure in 2060. Both the starting position and the trend are less favourable than the EU average.

The Federal Government identified this development at an early stage and has already taken appropriate action in various policy areas. In order to be able to fully meet the social and economic challenges posed by demographic change, in late 2011 the Federal Government drew up a "Report on the Demographic Situation and Future Trend in Germany" under the lead responsibility of the Federal Ministry of the Interior (*Bundesministerium des Innern*). The report describes demographic developments and analyses their impact on individual policy areas. Further, the report outlines measures taken so far by the Federal Government to shape demographic change and pinpoints where further action is needed. In spring 2012 the Federal Government will put forward a Demography Strategy based on that report which aims to maintain social cohesion in the face of demographic challenges and to ensure that sustainable growth and sound public finances are not jeopardised.

Once per legislative term the Federal Government analyses the impact of demographic developments on the long-term sustainability of public finances in a Sustainability Report compiled by the Federal Ministry of Finance. The report calculates what are known as "sustainability gaps" which indicate where action is needed to guarantee sound public finances. More specifically, it determines which lasting improvements need to be made to the structural primary balance in order to comply with intertemporal budget restrictions (i.e. in the long term all public expenditure and the debt ratio in the base period will be covered by public revenue) and in order to achieve a debt ratio of 60 % of GDP by the end of the period under review. The national report applies the same methodology used in the sustainability analyses carried out regularly by the European Commission in the course of its fiscal surveillance of Member States.

The most recent, Third Report on the Sustainability of Public Finances, which was published in autumn 2011, looks at the period to 2060 and provides evidence that the challenges when it comes to guaranteeing permanently sound public finances in Germany have increased since the last report was published in 2008. The sustainability gap calculated on the basis commonly applied at European level (meeting the intertemporal budget constraint) now stands at between 0.9 % and 3.8 % of GDP, depending on whether more optimistic or more pessimistic assumptions are made in regard to future demographic and economic developments. By contrast, in 2008 the gap still stood at between 0.0 % and 2.4 %. This deterioration is not least due to the impacts the financial and economic crisis has had on public finances. This is also evidenced by the interim calculation done in 2010, in which the sustainability gap was considerably higher (between 2.1 % and 5.2 %). The recent improvement confirms the success of the policy of consolidation pursued in Germany. However, the gap is still wide, indicating that adjustments are necessary. The regular analyses conducted as part of the Sustainability Report make a key contribution when it comes to firmly establishing in the minds of politicians and the general population the need for adjustment measures and the importance of sound public finances in the long term.

The results at national level are also confirmed by studies by the European Commission. The Commission also derives risk classifications from the sustainability gaps it determines. The European Commission will be publishing an update of its calculation of sustainability gaps and risk classifications in autumn 2012. Pursuant to the last analysis published at European level in 2009, Germany still belonged to the group of countries classed as being at “medium risk”. Only a few countries were classed as being at “low risk”, whilst the majority of EU countries belonged to the group classed as being at “high risk”.

6.2 Government revenue and expenditure from a long-term perspective

The determination of sustainability gaps is based on long-term budget projections. These are regularly compiled at EU level by the Working Group on Ageing of the Economic Policy Committee of the European Union and by the European Commission. The calculations focus on budget components which experience has shown are influenced most strongly by demographic developments, i.e. in particular spending on old-age protection (pensions and retirement pay), health and long-term care. The last projections were put forward in 2009. The model calculations are currently being updated and will be published shortly. Account is taken of ageing costs determined at EU level in the course of the fiscal surveillance of Member States.

The projection of age-related budget components also forms the basis for determining sustainability gaps at national level. As described in the above, the projection was last updated in autumn 2011. In order to take account of the uncertainties inherent to long-term projections, two basic variants are drawn up which make different assumptions to reflect long-term demographic and labour-market developments and other macroeconomic developments. The development of age-related expenditure is always shown in relation to GDP. As regards revenue, it is assumed that this develops in parallel to GDP, which means that the revenue ratio remains constant over time. Financial burdens deriving from the ageing population then only have an impact when the expenditure ratio increases. The model calculations confirm that demographic change will drive up government expenditure to a significantly higher level – if other conditions stay the same. For instance, in the base variant based on continuously optimistic assumptions, age-related expenditure will increase from just over 28 % of GDP in 2010 to just over 30 % of GDP in 2060. According to the pessimistic variant, by contrast, expenditure will rise to just over 34 % of GDP. The projected increase thus stands at 2 to 6 percentage points of GDP. The projections take account of demographic developments as well as of other risks, insofar as these can be usefully quantified. More specifically, the medium-term projection regarding the development of the debt ratio takes account of measures adopted so far in the context of stabilising the European Economic and Monetary Union.

This development will likely also be confirmed by those model calculations drawn up (and soon to be published) at Community level. If one bases these on the last EU-level projections, it is to be assumed that nearly all the other EU Member States will see a marked increase in age-related costs to 2060. In 2009, growth for EU Member States stood at a total of 4¾ percentage points of GDP (2007 to 2060), although the figures varied considerably between countries. Back then Germany stood at exactly the EU average (Table 18 in the Appendix).

The financial and economic crisis as well as the European sovereign debt crisis mean that consistent consolidation is necessary in the short and medium term. In addition, an eye must be kept on the challenges public finances will be facing in the long term. Reforms should thus, where possible, be designed so that they contribute to improving long-term sustainability. That in particular applies to the reform of the social security systems. Further, structural reforms to strengthen economic performance in the long term are key. They contribute directly to boosting confidence in the manageability of public deficits and debts, and are a co-factor of long-term sustainability.

6.3 Need for action and structural reforms in the social security systems

Long-term compliance with the budget rule will lead to a sustainable drop in Germany’s debt ratio even when cautious assumptions are made as to growth. This must be secured by corresponding measures.

Since demographic change will be accompanied by a drop in the working-age population, further efforts are needed to boost the supply of skilled workers in the long term. The Federal Government therefore aims to implement measures to further strengthen competitiveness as well as to further increase the labour force participation especially of older people and women, and to further reduce long-term unemployment. Among other measures, the step-wise increase in pensionable age to 67 years launched at the beginning of 2012 and the further expansion of childcare for young children will contribute to further increasing the working-age employment rates of older workers and women. During its reform of labour market policy instruments the Federal Government last year also launched an important measure aimed at integrating people into employment (in particular employment subject to the payment of social insurance contributions) by more effectively and more efficiently using existing instruments. Various labour market and education policy measures also serve to promote the employment especially of older workers and the long-term unemployed. Further, the Federal Government will, among other things, make Germany more attractive for highly qualified workers by amending immigration law in order to increase the number of highly qualified workers entering the country.

The Federal Government has already introduced important reforms in regard to social security systems. As regards the statutory pension insurance scheme, it was above all the introduction of the sustainability factor and the step-wise increase, since 1 January 2012, of the statutory retirement age to 67 years by 2029 which have led to a considerable strengthening of the system's financial sustainability. In addition, the Federal Government is promoting the establishment of an additional, funded pension system through company pensions and the so-called Riester pension (a state-sponsored private pension scheme). As for the statutory health insurance system, in 2011 the Federal Government provided for more sound financing through the Act on Sustainable and Socially Equitable Financing (*Gesetz zur nachhaltigen und sozial ausgewogenen Finanzierung*).

Moreover, the Federal Government has launched a bill to revise long-term care insurance (*Gesetz zur Neuausrichtung der Pflegeversicherung*). In particular, this project is aimed at providing needs-based benefits for people suffering from conditions involving dementia and at relieving the burden for family members in need of long-term nursing care. It further strengthens the principle of "outpatient over inpatient care". To finance this project the rate of contribution towards long-term care insurance will be increased by 0.1 contribution rate points at the beginning of 2013. Voluntary private insurance for services provided to those in need of long-term care are also to be promoted by means of tax incentives in addition to the current system of funded pension system.

Appendix

Table 8: Forecast of macroeconomic prospects

	ESA Code	2011	2011	2012	2013	2014 to 2016(3)
		Index 2005=100	% change p.a.			
1. Real GDP, chain index	B1g	109.68	3.0	0.7	1.6	1½
2. Nominal GDP (€bn)	B1g	2570.8	3.8	2.2	3.0	3
Components of real GDP, chain index						
3. Private consumption expenditure(1)	P.3	103.96	1.5	1.2	1.4	1½
4. Government consumption expenditure	P.3	112.39	1.4	1.0	1.3	1¼
5. Gross fixed capital formation	P.51	114.62	6.4	1.5	3.6	3
6. Changes in inventories (GDP growth contribution)(2)	P.52 + P.53	-	0.0	-0.1	0.0	0
7. Exports	P.6	133.32	8.2	2.0	4.3	4½
8. Imports	P.7	132.69	7.4	3.0	4.8	5
Contributions to real GDP growth(2)						
9. Domestic demand (excluding stocks)		-	2.2	1.2	1.7	1½
10. Changes in inventories	P.52 + P.53	-	0.0	-0.1	0.0	0
11. External balance of goods and services	B.11	-	0.8	-0.3	0.0	-0

2011: Federal Statistical Office (Statistisches Bundesamt), February 2012
2012 and 2013: Results of the short-term forecast for the 2012 Annual Projection (*Jahresprojektion 2012*), January 2012
2014 to 2016: Results of the medium-term forecast for the 2012 Annual Projection, January 2012
(1) Including private non-profit organisations serving households
(2) Contribution to GDP growth rate
(3) Values rounded to ¼

Table 9: Price developments – deflators

	ESA Code	2011	2011	2012	2013	2014 to 2016[2]
		Index (2005=100)	% change p.a.			
1. GDP		105.37	0.8	1.5	1.3	1¼
2. Private consumption expenditure[1]		108.51	2.1	1.7	1.6	1¾
3. Government consumption expenditure		107.23	1.5	2.2	1.7	1½
4. Gross capital formation		101.70	1.2	0.9	0.9	½
5. Exports		105.21	2.7	0.8	0.5	1
6. Imports		108.64	5.2	1.1	0.8	1

2011: Federal Statistical Office, February 2012
2012 and 2013: Results of the short-term forecast for the 2012 Annual Projection, January 2012
2014 to 2016: Results of the medium-term forecast for the 2012 Annual Projection, January 2012
(1) Including private non-profit organisations serving households
(2) Values rounded to ¼

Table 10: Labour market developments

	ESA Code	2011	2011	2012	2013	2014 to 2016[6]
		Level	% change p.a.			
1. Employment, persons (domestic)[1] (m)		41.1	1.3	0.5	0.2	-0
2. Employment, hours worked[2] (bn hours)		58.1	1.7	0.2	0.2	-0
3. Unemployment rate[3] (%)		-	5.8	5.4	5.2	5
4. Labour productivity[4] (2005=100)		104.0	1.6	0.1	1.4	1½
5. Labour productivity[5] (2005=100)		105.4	1.3	0.5	1.4	1¾
6. Compensation of employees (€bn)	D.1	1317.1	4.4	2.4	2.2	2½
7. Compensation per employee (thousand €)		36.0	3.0	1.9	2.1	2½

2011: Federal Statistical Office, February 2012
2012 and 2013: Results of the short-term forecast for the 2012 Annual Projection, January 2012
2014 to 2016: Results of the medium-term forecast for the 2012 Annual Projection, January 2012
(1) Occupied population, domestic concept
(2) National accounts definition
(3) Unemployed (ILO) / labour force
(4) Real GDP per person employed
(5) Real GDP (adjusted for price) per hour worked
(6) Values rounded to ¼; unemployment rate: value displayed is value for last year of forecast (2016)

Table 11: Sectoral balances

	ESA Code	2011	2012	2013	2014 to 2016(1)
		% of GDP			
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	5.3	4.8	4.5	4¼
of which:					
- Balance on goods and services		5.1	4.6	4.4	4
2. Net lending/borrowing of households	B.9	5.4	5.4	5.3	5
3. Net lending/borrowing of general government	EDP B.9	-1.0	-1	-½	0
4. Statistical discrepancy		-	-	-	-

2011: Federal Statistical Office, February 2012
Items 1 to 2: 2012 and 2013: Results of the short-term forecast for the 2012 Annual Projection, January 2012
2014 to 2016: Results of the medium-term forecast for the 2012 Annual Projection, January 2012
Item 3: Results of the forecast of the Stability Programme, values rounded to ½
(1) Values for items 1 to 2 rounded to ¼, value for item 3 rounded to ½; value in last year of forecast (2016)

Table 12: General government budgetary prospects

	ESA Code	**Year 2011**	**Year 2011**	**Year 2012**	**Year 2013**	**Year 2014**	**Year 2015**	**Year 2016**
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector								
1. General government	S.13	-25.8	-1.0	-1	- 1/2	-0	0	0
2. Central government	S.1311	-27.0	-1.0	-1	- 1/2	- 1/2	-0	-0
3. State government	S.1312	-14.8	-0.6	- 1/2	- 1/2	- 1/2	-0	-0
4. Local government	S.1313	0.8	0.0	0	1/2	1/2	1/2	1/2
5. Social security funds	S.1314	15.1	0.6	1/2	0	0	0	0
General government (S13)								
6. Total revenue	TR	1,148.2	44.7	45	44 1/2	44 1/2	44 1/2	44 1/2
7. Total expenditure	TE[1]	1,174.0	45.7	46	45 1/2	44 1/2	44 1/2	44 1/2
8. Net lending/borrowing	EDP B.9	-25.8	-1.0	-1	- 1/2	-0	0	0
9. Interest expenditure	EDP D.41	67.7	2.6	2 1/2	2 1/2	2 1/2	2 1/2	2 1/2
10. Primary balance[2]		41.9	1.6	1 1/2	2	2 1/2	2 1/2	3
11. One-off and other temporary measures[3]		-3.5	-0.1	0	0	0	0	0
Selected components of revenue								
12. Total taxes (12=12a+12b+12c)		587.8	22.9	23 1/2	23 1/2	23 1/2	23 1/2	23 1/2
12a. Taxes on production and imports	D.2	292.1	11.4	11 1/2	11 1/2	11 1/2	11	11
12b. Current taxes on income, wealth, etc	D.5	295.7	11.5	12	12	12	12 1/2	12 1/2
12c. Capital taxes	D.91	0.0	0.0	0	0	0	0	0
13. Social contributions	D.61	435.3	16.9	17	16 1/2	16 1/2	16 1/2	16 1/2
14. Property income	D.4	26.5	1.0	1	1	1	1	1
15. Other [4]		98.6	3.8	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2
16=6. Total revenue	TR	1,148.2	44.7	45	44 1/2	44 1/2	44 1/2	44 1/2
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)5		1,023.1	39.8	40	40	40	40	40
Selected components of expenditure								
17. Compensation of employees + intermediate consumption	D.1+P.2	327.5	12.7	12 1/2	12 1/2	12 1/2	12	12
17a. Compensation of employees	D.1	199.8	7.8	8	7 1/2	7 1/2	7 1/2	7 1/2
17b. Intermediate consumption	P.2	127.7	5.0	5	5	5	4 1/2	4 1/2
18. Social payments (18=18a+18b)		630.9	24.5	24 1/2	24 1/2	24 1/2	24 1/2	24 1/2
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D,63131	207.4	8.1	8 1/2	8 1/2	8 1/2	8 1/2	8 1/2
18b. Social transfers other than in kind	*D. 62*	423.5	16.5	16 1/2	16	16	16	15 1/2
19=9. Interest expenditure	EDP D.41	67.7	2.6	2 1/2	2 1/2	2 1/2	2 1/2	2 1/2
20. Subsidies	D.3	26.2	1.0	1	1	1	1	1
21. Gross fixed capital formation	P.51	42.3	1.6	1 1/2	1 1/2	1 1/2	1 1/2	1 1/2
23. Other[7]		79.5	3.1	3	3	3	3	3
24=7. Total expenditure	TE[1]	1,174.0	45.7	46	45 1/2	44 1/2	44 1/2	44 1/2
p.m.: Government consumption (nominal)	P.3	502.9	19.6	20	19 1/2	19 1/2	19 1/2	19 1/2

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] Includes cash benefits (D.621 and D.624) and in kind benefits (D.631) related to unemployment benefits.

[7] D.29+D4 (other than D.41)+ D.5+D.7+P.52+P.53+K.2+D.8.

Figures for the forecast years are rounded to half a percentage point of GDP.

Table 13: Breakdown of revenue

	Year 2011	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015	Year 2016
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Total revenue at unchanged policies	13,992.0	43.9	45	44 1/2	44 1/2	44 1/2	44 1/2
2. Discretionary revenue measures	13.6	0.7	0	0	-0	-0	-0

Figures for the forecast years are rounded to half a percentage point of GDP.

Table 14: Expenditure to be excluded from the expenditure benchmark

	Year 2011	Year 2011	Year 2012	Year 2013	Year 2014	Year 2015	Year 2016
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	3.9	0.2	0	0	0	0	0
2. Expenditure fully matched by mandated revenue increases	8.1	0.3	0	0	0	0	0
3. Non-discretionary changes in unemployment benefit expenditure	-3.4	-0.1	-0	-0	-0	-0	-0

Figures for the forecast years are rounded to half a percentage point of GDP.

Table 15: General government debt developments (Maastricht definition)

% of GDP	ESA Code	2011	2012	2013	2014	2015	2016
1. Gross debt		**81.2**	**82**	**80**	**78**	**76**	**73**
2. Change in gross debt ratio		**1.2**	**2 1/2**	**1/2**	**0**	**-0**	**- 1/2**
Contributions to changes in gross debt							
3. Primary balance		1.6	1 1/2	2	2 1/2	2 1/2	3
4. Interest expenditure	EDP D.41	2.6	2 1/2	2 1/2	2 1/2	2 1/2	2 1/2
5. Stock-flow adjustment		2.5	15 1/2	-1	1/2	-1	-2 1/2
p.m.: Implicit interest rate on debt[1]		3.3	3 1/2	3 1/2	3 1/2	3 1/2	3 1/2

[1]Proxied by interest expenditure divided by the debt level of the previous year.

Figures for the forecast years are rounded to half a percentage point of GDP.

Table 16: Cyclical developments

% of GDP	ESA Code	2011	2012	2013	2014	2015	2016
1. Real GDP growth (%)		3.0	0.7	1.6	1.6	1.6	1.6
2. Net lending of general government	EDP B.9	-1.0	-1	- 1/2	-0	0	0
3. Interest expenditure	EDP D.41	2.6	2 1/2	2 1/2	2 1/2	2 1/2	2 1/2
4. One-off and other temporary measures[1]		-0.1	0	0	0	0	0
5. Potential GDP growth (%)		1.4	1.5	1.5	1.3	1.3	1.3
contributions:							
- labour		0.6	0.5	0.4	0.1	0.0	0.0
- capital		0.4	0.4	0.4	0.5	0.5	0.5
- total factor productivity		0.5	0.6	0.7	0.7	0.8	0.8
6. Output gap		-0.2	-1.0	-0.9	-0.6	-0.3	0.0
7. Cyclical budgetary component		-0.1	- 1/2	- 1/2	- 1/2	-0	-0
8. Cyclically-adjusted balance (2 - 7)		-0.9	- 1/2	- 1/2	0	0	0
9. Cyclically-adjusted primary balance (8 + 3)		1.7	2	2 1/2	2 1/2	3	3
10. Structural balance (8 - 4)		-0.7	- 1/2	- 1/2	0	0	0

[1]A plus sign means deficit-reducing one-off measures.
Figures for the forecast years are rounded to half a percentage point of GDP.

Table 17: Divergence between the forecasts in the April 2012 and the April 2011 stability programmes

	ESA Code	2011	2012	2013	2014	2015	2016
Real GDP growth (%)							
Previous update		2.3	1.8	1.6	1.6	1.6	-
Current update		3.0	0.7	1.6	1.6	1.6	1.6
Difference		0.7	-1.1	0.0	0.0	0.0	-
General government net lending (% of GDP)	EDP B.9						
Previous update		-2 1/2	-1 1/2	-1	- 1/2	- 1/2	-
Current update		-1.0	-1	- 1/2	-0	0	0
Difference		1 1/2	1/2	1/2	1/2	1/2	-
General government gross debt (% of GDP)							
Previous update		82	81	79 1/2	77 1/2	75 1/2	-
Current update		81.2	82	80	78	76	73
Difference		- 1/2	1	1	1	1/2	-

Figures for the forecast years are rounded to half a percentage point of GDP.

Table 18: Development of age-related general government expenditure from a long-term perspective

	2007	2020	2030	2040	2050	2060
	Expenditure as % of GDP					
Pension expenditure(1)	10.4	10.5	11.5	12.1	12.3	12.8
p.m.: Contribution revenue(2)	7.2	6.9	7.8	8.3	8.4	8.6
Healthcare expenditure(3)	7.4	8.1	8.5	9.0	9.2	9.2
Long-term care expenditure(4)	0.9	1.2	1.4	1.8	2.2	2.4
Education expenditure(5)	3.9	3.2	3.3	3.4	3.4	3.5
Unemployment insurance(6)	0.9	0.6	0.6	0.6	0.6	0.6
	Assumptions					
Productivity gains (%)	1.5	1.7	1.7	1.7	1.7	1.7
Potential growth (%)	1.4	1.5	1.3	1.1	1.0	1.0
Labour force participation (%)						
- Men (15 to 64)	82.1	83.9	83.2	83.3	82.9	83.0
- Women (15 to 64)	70.2	74.1	75.3	77.0	76.5	76.5
Unemployment rate	8.7	6.2	6.2	6.2	6.2	6.2
Old-age dependency ratio	29.9	35.3	46.2	54.7	56.4	59.1
Total population (m)	82.3	81.5	80.2	77.8	74.5	70.8
Population aged 65+ (m)	16.3	18.6	22.1	24.2	23.6	23.0

Source: Results of model calculations by the Economic Policy Committee of the EU (EPC) and the European Commission (DG ECFIN) presented in *The 2009 Ageing Report*.

(1) Statutory pension insurance and civil servants' pensions
(2) Statutory pension insurance
(3) Statutory health insurance
(4) Social long-term care
(5) Excluding education expenditure by the Federal Employment Agency (Bundesanstalt für Arbeit)
(6) Wage replacement benefits

Comments: The dynamisation of expenditure on long-term care in line with the amount of the change in GDP per person in employment that is assumed in the reference scenarios does not correspond to current legislation. An alternative calculation based on applicable law and using a medium-term development in payments corresponding to the general rate of inflation produces a rise of a maximum 1.1 % of GDP in 2050. Statements about productivity gains (measured using labour productivity) and potential growth (measured using aggregate potential output) relate to changes against the previous year. In the case of the old-age dependency ratio, the limits for the population of working age (15-64) are the same as those for labour force participation. Work is currently underway at Community level to update Eurostat's population projections and the long-term calculations for the macroeconomic and fiscal development for all 27 Member States of the EU. It is anticipated that this work will be concluded this year.

Table 19: Contingent liabilities

% of GDP	**Year 2011**
Public guarantees	21.0 *
Of which: linked to the financial sector	2.7

* Year 2010

Table 20: Technical assumptions

		2011	2012	2013	2014 to 2016
Short-term interest rate (annual average)		1.3	1	1	1
USD/€ exchange rate (annual average)		1.4	1.3	1.3	1.3
Growth of German sales markets(1)		6½	2½	5	5
Oil price (Brent, USD/barrel)		111	109	109	109

(1) Values rounded to ¼