

# Germany

<b>Chancellor:</b> Angela MERKEL	<b>Population</b> (2007 est.): 82,314,906			
<b>Finance Minister:</b> Peer STEINBRUECK	<b>GDP</b> (2007): €2422.9 billion			
<b>Central Bank Governor:</b> Axel A. WEBER	<b>GDP/capita:</b> €29,500			
<b>Joined the EU:</b> 1957	<b>GDP by sector:</b>			
<b>Adopted the Euro:</b> 1999	Agriculture 0.8%			
<b>Currency prior to Euro:</b> Deutschmark	Industry 29%			
	Services 70.1%			
	<b>Life Expectancy</b> (women / men): 82 / 77			
	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008*</b>
<b>Real GDP growth rate</b>	0.8%	3.0%	2.5%	1.7%
<b>Inflation</b>	1.9%	1.8%	2.3%	3.0%
<b>Unemployment Rate</b>	10.7%	9.8%	8.4%	7.3%

\* forecast

## Germany in the EU and the Euro Area

In 1957, Germany was one of the first six Member States to join the European Economic Community (EEC), one of predecessors of the EU. Germany was also one of the founding members of the Euro Area, and adopted the Euro in 1999. Euro notes and coins were introduced on January 1, 2002, replacing the Deutsche Mark.

Originally it was only West Germany which became part of the EEC, the east remaining tied with Soviet Russia. Only in 1990, following re-unification of east and west, did the whole of Germany enter the EEC, all of which caused significant political, economic and demographic upheaval.

## Economic Overview of Germany

Germany is the world's fifth largest economy as well as one of the most advanced. Its GDP growth of 2.5% in 2007 was largely driven by growth in exports and increasing consumer demand at home and is seen very much as a reflection of the successes in solving some of the economic problems of re-unification. However, the modernization and integration of the eastern German economy continues to be a costly long-term process, with annual transfers from west to east amounting to roughly \$80 billion. Stronger growth led to a considerable fall in unemployment to about 8% near the end of 2007. Among the most important reasons for Germany's high unemployment during the past decade were poor economic growth, low domestic consumption, lack of competition in the service sector, and high interest rates. And unemployment is starting to rise again as economic growth in Germany falters as a result of the global financial and economic crisis.

The slowdown of economic activity in key trading partners and a stronger euro have led to an abrupt deceleration of export growth. At the same time, high food and energy prices have weighed heavily on private consumption. The global financial crisis and adjustments in the

housing sector in a number of countries have triggered a sharp deceleration of economic activity both inside and outside the EU. As a heavily export-oriented economy, Germany will be directly affected by this global downturn.

The Executive Board of the IMF<sup>1</sup> considered that the main challenges facing the German authorities are the need to maintain short-term stability, especially in the financial sector, and to persist with the outstanding medium-term reform agenda. The global economic slowdown, the strength of commodity prices, and financial tensions are having their impact on Germany. Skills shortages need to be addressed by improving education and training and by encouraging the immigration of skilled workers, as part of an effort to raise Germany's potential growth rate.

### Some Economic Challenges Facing Germany

The gap in GDP per capita vis-à-vis best performing countries remains wide. Long-term unemployment is still high and hours worked per employed worker are low.<sup>2</sup>

#### *High Taxes Reduce Incentive to Work*

The average taxes on double-earner and single-earner households are relatively high. This has the advantage of facilitating extensive public welfare systems though it also has the adverse effect of impinging significantly on individuals' take home pay. Some believe that this in turn is reducing incentives to work and remain in employment, thus increasing unemployment. In its attempts to address this problem, the government has reduced spending on labor policies and increased the statutory pension age, thus moderating the need for high income taxes. Increases in value added tax (VAT) revenue have also been beneficial in this respect. However, it remains a hotly contested political debate as to how far income taxes should be reduced further.

#### *Long-term unemployment and low full-time female labour force participation*

To reduce high long-term unemployment, administrative responsibilities related to job placement must be assigned more effectively. Although female labour force participation is in general quite high, it is mostly in part time work. Due to lack of access to childcare facilities and full-day schooling as well as tax burdens on second earners full-time female labour force participation remains low. The government already took action to a certain extent by providing subsidies for a large increase in the number of childcare places and by promoting full-day schools.

#### *Inefficient Education System*

Educational results for a large share of 15-year-olds are weak, and the numbers of university graduates remain significantly lower than in other EU countries. To overcome the effects of a narrowed skill base and the reduction of prospects for innovation, the performance of all schools should be evaluated against nation-wide standards, schools should be given more autonomy and participation in early childhood education should be increased.

#### *Regulatory Barriers to Competition*

There are restrictive regulations placed upon professional services and the opening of craft based businesses. Administrative burdens on enterprises are also high, particularly in terms of compliance with complex regulations upon entry to network industries, which again acts as a disincentive for new firms to enter. Restrictions on large-scale retailers need to be relaxed and liberal professions need to be deregulated, to face the problems in competitiveness still ahead.

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<sup>1</sup> International Monetary Fund (IMF), <http://www.imf.org/external/np/sec/pn/2008/pn0826.htm> 06/13/2008

<sup>2</sup> "Economic Reform: Going for Growth." OECD. 2008