



## **Launch of the Economic Survey of Germany**

**Speech by Angel Gurría,  
Secretary-General  
OECD**

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It is a pleasure to be here to present our 2008 Economic Survey of Germany on behalf of all our Member countries. They now call Berlin “the city of change” — it is an ideal place to come and talk to you about Germany’s economic progress.

### **A timely Survey**

The publication of this Economic Survey could hardly come at a better time.

After years of stagnation, Germany has been enjoying a strong economic upswing. While growth is seen to be slowing down from the high rates seen over past years, it is projected to continue around its long-run potential rate, which we estimate to be around 1½ per cent. So far the real economy has not been affected strongly by the global financial turmoil, the appreciation of the euro and high oil prices. Early estimates for growth in the first quarter of 2008 do not yet indicate a slowdown contrary to developments in other G7 countries.

German exports are still growing strongly, reflecting past gains in competitiveness. Investment growth also remains solid. The favourable profit situation has so far helped German companies weather the storm of deteriorating financial conditions. However, sooner or later the headwinds coming from the international economy will take their toll via a slowdown in export growth. Such a slowdown could be countered to some extent by a pick-up of private consumption which we expect on the back of employment gains and rising incomes. In this regard, wage settlements so far indicate that past wage moderation has come to an end.

## **Credit for past reforms, which show first positive results**

In recent years, Germany has progressed with reforms in several areas and positive payoffs are visible. One area is fiscal policy: The general government budget has been balanced after having reached a deficit of 4% of GDP in 2003. This has been achieved through a significant expenditure restraint. The corporate tax reform (implemented in January 2008) has brought German tax rates – which were among the highest in the OECD – closer to the OECD average. The labour market (*Hartz*) reforms implemented since 2003 are bringing more people into work. This is most visibly for older workers. We estimate that the *Hartz IV* reform implemented in 2005 alone will lead to a decline in the structural unemployment rate by ½ percentage point. Non-wage labour costs have been cut—following a long-standing OECD recommendation, in exchange for an increase in VAT rates.

## **The current growth momentum should be used to implement further reforms**

For high economic growth to be more enduring, it will be necessary to raise the growth rate of potential output. To this end, the Survey offers in-depth analysis, assessments and recommendations on which areas to focus with structural reforms. The opportunity to implement reforms in a favourable economic environment with strong labour market performance should not be missed, as this minimises reform costs.

The government should build on past achievements – preserving them and going further as it is clear that past efforts had positive effects. The key areas to focus on are fiscal policy, labour markets, education (the in-depth structural theme of this Survey), competition in network industries and healthcare financing.

### ***Achievements in fiscal policy must be preserved to deal with long-term challenges***

For the first time since 1989, the general government budget is now in balance. The government is debating whether to introduce the requirement of a balanced structural budget into the constitution (along the lines of the Stability and Growth Pact). We strongly support these efforts and would recommend complementing such a rule by making the underlying expenditure path public and binding. Improving the fiscal framework along these lines would help Germany to deal with long-term fiscal challenges (arising from ageing costs) and to avoid pro-cyclical policies. Also, it would send a strong signal in support of fiscal consolidation to other countries.

### ***Reform momentum on the labour market needs to be maintained***

The labour market is booming and the unemployment rate has fallen to a 7-year low. The recent labour market reforms are contributing to this outcome, which is most visible in the employment rates of older workers which have increased by 10 percentage points.

Introducing counterproductive measures should be avoided. In this sense, the recent decision to set minimum wages by legal extension of sectoral wage agreements is unfortunate as it can be used to prevent competition. Indeed, the recently introduced minimum wage in the postal services (at € 9.80 for post delivery services) severely hampered the development of competition in this sector. The latest ruling against the minimum wage in the postal sector by a local court in Berlin could be a good opportunity to reconsider the current arrangement.

We are not advocating a minimum wage as international evidence shows that interventions into the wage determination mechanism are risky. But if the government deems a minimum wage to be necessary, it should be set at a nation-wide basis and at a level which does not hinder employment. An independent expert committee should decide on its level.

The German population is ageing and this means that less people will be available to participate in the labour force. This reinforces the need to lift restrictions to work more; particularly in the case of skilled workers. Efforts should concentrate on raising the number of hours worked per person employed which are among the lowest in the OECD. Notably, the significant disincentives for married women to work longer hours should be lowered. This includes moving away from joint taxation towards individual taxation. The government's plans to extend the supply of childcare are very welcome.

The currently robust labour market performance is a golden opportunity to improve labour demand by lowering employment protection legislation for regular jobs. We recommend replacing the courts-based system for job dismissal for economic reasons with a formula-based severance payment regime. This would make the system more transparent, less uncertain and would help to create more regular and stable jobs.

### ***Education achievement and the number of tertiary graduates must increase***

Labour market outcomes could also be improved over the long run by further efforts to raise education outcomes, which would in turn also raise productivity. Acknowledging its importance, Germany has implemented major reforms; like strengthening pre-school education and educators' accountability through the introduction of centralised exit exams in secondary schools. However, there remains considerable scope to build on these reforms to improve outcomes further. This is why the Survey devotes an in-depth chapter to this topic.

Overall, average student achievement in Germany is satisfactory. The 2006 PISA scores were above average in science (8<sup>th</sup> rank among OECD countries) and average in reading and mathematics (both 14<sup>th</sup> rank). However, there is no reason why Germany should not aim higher! Weaker students tend to do badly by international comparison; while socio-economic or immigrant background has a large impact on outcomes. Reforms to raise participation in pre-school education, to improve teacher quality and to reduce stratification would be important in this regard.

A second area of concern is tertiary attainment. The number of tertiary graduates is falling behind other OECD countries. In the age group 25-34, only 22% have tertiary education, compared with an OECD average of 32%. About one quarter of secondary school graduates who would be eligible for continuing with university education chose not to do so. Obviously, university education must be made more attractive in order to prepare Germans for employment careers with a high earnings potential. This could be achieved —like in other leading OECD member countries— by giving universities more funding autonomy, allowing them to adjust their programmes more swiftly to the needs of highly qualified and ambitious labour market entrants.

Finally let me make a couple of comments on a key area for the improvement of Germany's economic performance:

***The need to increase competition in network industries***

There is a lack of competition in energy markets as incumbents own and operate the networks, keeping energy prices in Germany significantly above the European average. The Survey argues that a stronger form of vertical separation of the energy companies is needed. The European Commission has advocated ownership unbundling, which the government resisted because this would interfere with private ownership rights. Recently however, E.ON (one of the large incumbents) has decided to sell its networks and apparently other companies are thinking along these lines, too. We welcome this development as a market-driven solution, backed by strong regulatory intervention.

The government is currently discussing options for the privatisation of the railway incumbent. We stress that the lessons from the liberalisation of the energy sector should be learned, namely that network ownership and operation need to be strictly separated from transport services.

This is just a little taste of what you will read in more depth in our Survey, which – by the way – also includes a chapter on how to deal with the long-term challenge of rising healthcare costs.

In these times of global financial turbulence and economic uncertainty, it is important not to lose sight of the long-term challenges. Reforms are not an end in themselves, but a means to procure more and better jobs for our people. The German economy has so far resisted quite well the impact of the US sub-prime crisis and the burden of a strong euro and expensive commodities. But the risks persist and reforms are the only available medicine to increase the resilience of our economies against contagion.

Germany has taken many steps in the right direction in recent years. Let's make sure that it continues this course. This OECD Survey is written to help with this task.