
Country Profile 2008

Germany

This Country Profile provides an overview of the country's politics, resources and economy. It is revised and updated annually.

Economist Intelligence Unit
26 Red Lion Square
London WC1R 4HQ
United Kingdom

Economist Intelligence Unit

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London

The Economist Intelligence Unit
26 Red Lion Square
London
WC1R 4HQ
United Kingdom
Tel: (44.20) 7576 8000
Fax: (44.20) 7576 8500
E-mail: london@eiu.com

New York

The Economist Intelligence Unit
The Economist Building
111 West 57th Street
New York
NY 10019, US
Tel: (1.212) 554 0600
Fax: (1.212) 586 0248
E-mail: newyork@eiu.com

Hong Kong

The Economist Intelligence Unit
60/F, Central Plaza
18 Harbour Road
Wanchai
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
E-mail: hongkong@eiu.com

Website: www.eiu.com

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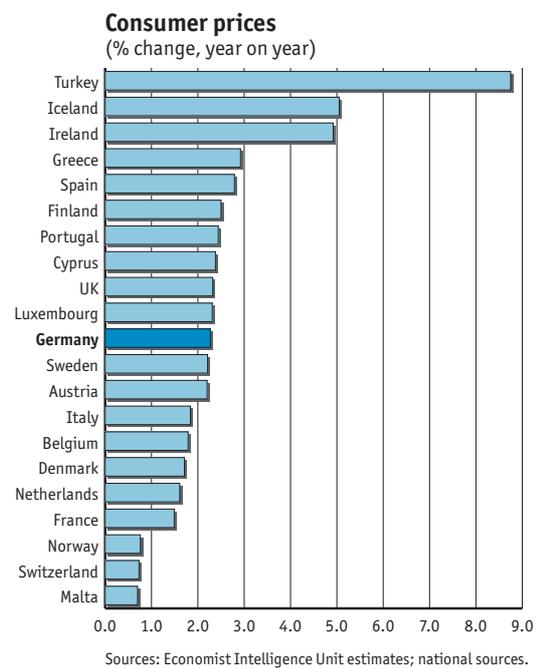
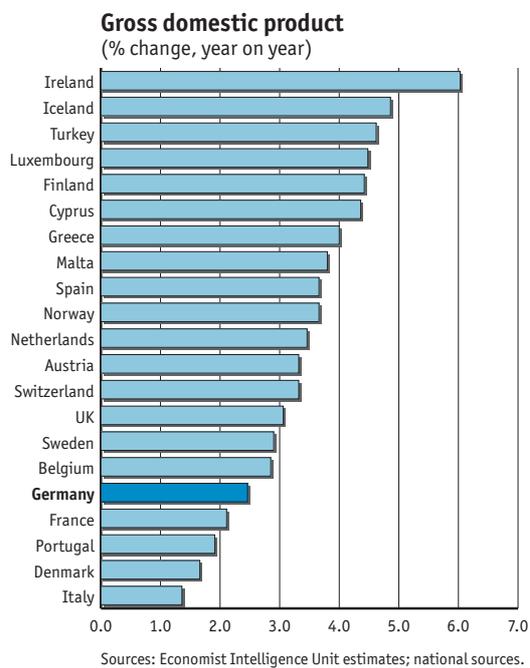
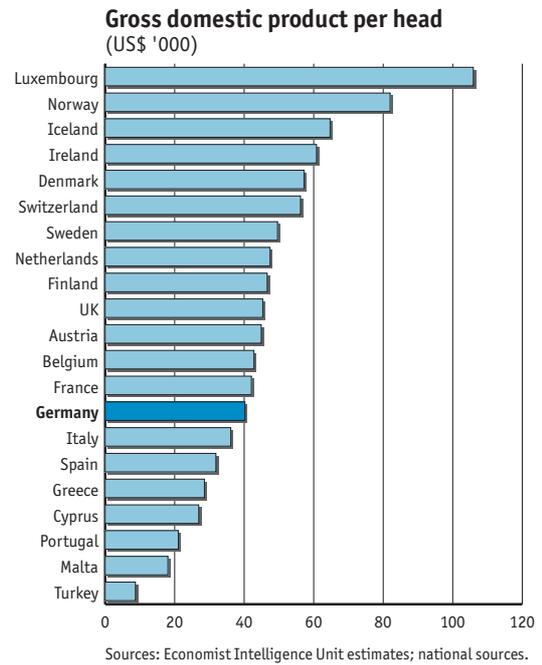
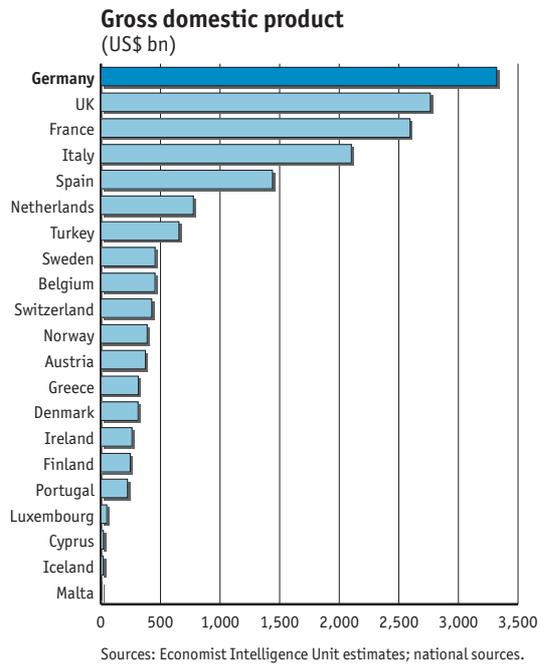
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"n/a" means not available; "--" means not applicable

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Comparative economic indicators, 2007



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Germany

Basic data

Land area	356,970 sq km, of which 55% is agricultural land and 29% forest
Population	82.6m (2007)
Main cities	Population in '000 (mid-2003)
	Berlin (capital) 3,389
	Hamburg 1,734
	Munich (München) 1,248
	Cologne (Köln) 966
	Frankfurt am Main 643
	Dortmund 590
Climate	Temperate
Weather in Frankfurt (altitude 125 metres)	Hottest month, July, 15-20°C (average daily minimum and maximum); coldest month, January, minus 1-3°C; driest month, February, 40 mm (average monthly rainfall); wettest month, June, 70 mm
Language	German
Weights and measures	Metric system
Currency	Euro (€=100 cents), which was introduced on January 1st 1999 and against which the D-mark (DM=100 pfennig) was permanently fixed at DM1.95583:€1. Euro notes and coins were introduced in January 2002 Average exchange rates in 2007: US\$1.37:€1 Exchange rates on September 22nd 2008: US\$1.48:€1
Time	1 hour ahead of GMT in winter, 2 hours ahead in summer
Fiscal year	January-December
Public holidays	January 1st, Good Friday, Easter Monday, May 1st, Ascension Day, Whit Monday, Corpus Christi, October 3rd (Reunification Day), December 25th and 26th; additional public holidays apply for various states

Highlights

Politics

- Germany is a stable democracy organised on federal lines. The current federal government is a grand coalition of the country's two major political groups, the Christian Democratic Union/Christian Social Union (CDU/CSU) and the Social Democratic Party (SPD) under the chancellor, Angela Merkel (CDU). It came to power, for a four-year term, in November 2005.

- German reunification took place on October 3rd 1990 just under a year after the opening of the frontiers and the collapse of the communist regime of the former German Democratic Republic. The absorption into a successful free-market democracy of a region that had not enjoyed political or economic freedom for nearly 60 years has been more difficult than anticipated and is not yet complete.

Demographics and resources

- According to the US census bureau, Germany's population stood at 82.6m in 2007. Demographic projections by the Federal Statistics Office from 2006 suggest a decline of the population to 72m by 2050, as the fertility rate remains well below the replacement ratio and net immigration is low.

- Germany's primary natural resource is coal—both hard coal and lignite. There are no significant other energy resources. Other minerals include potash, of which the former East Germany was a major producer, and small quantities of rare minerals, including uranium, cobalt, bismuth and antimony, which are mined.

The economy

- More than in most other advanced economies, manufacturing and related services are still at the heart of the German economy. The demand components of German economic growth are in large part in line with the average in other developed economies, with the exception of a larger than usual proportion of GDP accounted for by exports.

- From 2001-05 Germany suffered its lowest period of economic growth in the post-war period, with feeble domestic demand accounting for the near-stagnation. By contrast, the global economic upturn triggered an export boom. In 2006 domestic demand started to recover. GDP grew by 2.9% in 2006 and by 2.5% in 2007.

- Apart from temporary price rises after the oil crises of the 1970s, Germany has a strong track record on price stability. There was an upsurge in the early 1990s and again in 2008. The recent spike was, driven by steep rises in food and energy prices.

- Public debt is high, but falling, reflecting renewed fiscal discipline after decades of deficits. The return to the black has been achieved largely by curbing expenditure growth. Monetary policy is set by the European Central Bank.

- West Germany's current account was in surplus for most of the period from the mid-1950s until reunification in 1990, but in 1991 the current account swung into deficit. There were deficits in all subsequent years up to 2000, but the situation has since changed, and the country has returned to its tradition of large current-account surpluses.

Politics

Germany is a federal democracy. The 16 states have an important role in the legislative process at the federal level and independent responsibilities, particularly in the fields of education and policing. The current government is a grand coalition of the country's two major political groups, the Christian Democratic Union/Christian Social Union (CDU/CSU) and the Social Democratic Party (SPD) under the chancellor, Angela Merkel (CDU). It came to power in November 2005 and new elections are due by September 2009.

Political background

The second world war ended with Germany's catastrophic defeat and occupation by the victorious powers—France, the Soviet Union, the UK and the US—each of which occupied a zone of the country. Between 1945 and 1949 Germany ceased to exist as a state. Rising east-west tensions played a role in encouraging the US, the UK and France to unify their zones and grant the new West Germany political autonomy. Thus, Germany was divided and two states created: the Federal Republic of Germany (West Germany) and the German Democratic Republic (East Germany). The Basic Law or constitution came into force in West Germany on May 24th 1949. Until 1965 the West German government was dominated by the CDU and its Bavarian sister party, the CSU, for much of the time under the chancellor, Konrad Adenauer.

After it had purged Marxism from its party programme in 1959, the SPD joined the CDU/CSU in government in 1966. This grand coalition broke up after the 1969 general election, when it was replaced by a coalition of the SPD and the small liberal Free Democratic Party (FDP), with Willy Brandt (SPD) as chancellor. His main policy aim was détente with the communist countries to the east. This led to the so-called Basic Treaty between East Germany and West Germany, signed in December 1970, which provided for a *modus vivendi* between the two countries and facilitated their entry into the UN in September 1973. Mr Brandt resigned in May 1974 in the wake of a spy scandal and was replaced by his minister of finance, Helmut Schmidt, who was chancellor until 1982.

A recession and tensions both within the SPD and between the SPD and the FDP led to the breakdown of the SPD-FDP coalition and the formation of the CDU/CSU-FDP coalition under the chancellorship of Helmut Kohl in 1982, which lasted until 1998. It owed its longevity to the solidity of Mr Kohl's leadership, particularly during the period before and after German reunification, and the inability of the opposition SPD to recapture the political agenda. However, after the post-unification boom, the Kohl government suffered as the economy slumped and it failed to push through reform, not least because the SPD used its control of the upper house of parliament, the Bundesrat, to block government initiatives.

The fall of the Berlin Wall at the Brandenburg Gate on November 9th 1989 was the most dramatic event in the lead-up to German reunification on October 3rd 1990. The East Germans had been galvanised into mass protests by the many

failures of the 40-year old communist state. As it became clear that the Soviet Union had lost its appetite to curb reform using its military power, the communist state quickly collapsed. In an effort to smooth the reabsorption of the communist part of the country into the larger democratic and free-market Federal German Republic, a currency union took place on July 1st 1990. Essentially valueless East German marks were exchanged at an overly favourable exchange rate, a move that had negative effects for the competitiveness of the former communist part of the country, but which ensured that what little wealth its inhabitants possessed was protected. Five states from East Germany and a unified Berlin, replacing West Berlin as a state, joined the ten states of West Germany under the provisions of Article 23 of the Federal Republic's constitution.

Political forces and institutions

Christian Democratic Union (CDU)

The CDU was the most important party in West Germany in the period after the second world war, and is now one of the two main parties, together with the SPD. CDU foreign policy is based on strong support for both the Atlantic alliance and for European integration. The CDU is somewhat divided on economic policy but is strongly influenced by the concept of the "social market" developed in the 1950s by Ludwig Erhard, then minister of finance, which sets out a dominant role for the market alongside state intervention to prevent social hardship.

Christian Social Union (CSU)

The CSU, the sister party of the CDU, is represented only in Bavaria, where the CDU does not compete in elections. The CSU takes a more conservative stance than the CDU on social issues such as abortion and immigration, reflecting the strong Roman Catholic traditions of Bavaria. It has also been more reluctant to back liberal positions on economic policy questions. The CSU vehemently defends the powers of the states vis-à-vis the federal government and is more sceptical about EU integration than either the CDU or the SPD.

Bundestag election results 1949-2002

(% of votes unless otherwise indicated)

	1949	1953	1957	1961	1965	1969	1972	1976	1980	1983	1987	1990	1994	1998	2002	2005
CDU/CSU	31.0	45.2	50.2	45.3	47.6	46.1	44.9	48.6	44.5	48.8	44.3	43.8	41.5	35.2	38.5	35.2
SPD	29.2	28.8	31.8	36.2	39.3	42.7	45.8	42.6	42.9	38.2	37.0	33.5	36.4	40.9	38.5	34.2
FDP	11.9	9.5	7.7	12.8	9.5	5.8	8.4	7.9	10.6	6.9	9.1	11.0	6.9	6.2	7.4	9.8
Greens	n/a	1.5	5.6	8.3	5.0	7.3	6.7	8.6	8.1							
PDS/Left Party ^a	n/a	2.4	4.4	5.1	4.0	8.7										
Others	27.8	16.5	10.3	5.7	3.5	5.5	0.9	0.9	0.5	0.5	1.2	4.2	3.5	5.9	3.0	3.9
Turnout ^b	78.5	86.0	87.8	87.7	86.8	86.7	91.1	90.7	88.6	89.1	84.3	77.8	79.0	82.3	79.7	77.7

^a The PDS was renamed Left Party in 2005. ^b % of eligible voters.

Source: Gert-Joachim Glaessner, *Demokratie und Politik in Deutschland* Bundeswahlleiter.

Social Democratic Party (SPD)

The SPD abandoned its commitment to Marxism in 1959, approving a new party strategy, the Bad Godesberg Programme, which paved the way for a period in government between the mid 1960s to the early 1980s. Internal divisions between left-wing and centrist factions and a shift to the left during

the latter part of its extended period in power contributed to its failure to win elections between 1983 and 1994. A return to the centre under Gerhard Schröder played an important role in the SPD's election victory in 1998. Despite the fact that a far-left faction split from the main party before the 2005 election, there is still a substantial section of the party that wants to retain its left-wing tradition and is therefore unhappy with the current policies of the coalition government. There are also divisions within the SPD over how close an ally of the US Germany should be.

Free Democratic Party (FDP)

For almost 50 years the party enjoyed the position of king-maker by forming coalitions with the large parties, the CDU/CSU and the SPD, between 1949 and 1998, except in 1966-69. Following reunification, the FDP found it difficult to establish itself in eastern Germany and was also weakened in western Germany, but a period in opposition at the federal level, which resulted in some rejuvenation, has allowed it to regain some of its former strength in western Germany. A liberal party in the European rather than the US sense, the FDP generally believes in limiting government interference, but there are internal divisions on law and order issues.

The Greens

The Greens, founded as a party at the federal level in January 1980, started to have a major influence on the political scene by placing environmental issues squarely on the political agenda. During the 1980s and the early 1990s the Greens often suffered from infighting between radical and moderate factions, with the latter winning out and leading the party into coalition with the SPD in 1998. Initially, the party's focus was on environmental and anti-military issues, but its agenda gradually widened and now encompasses a full spectrum of the political agenda.

Party of Democratic Socialism (PDS)/Left Party

After the fall of the Berlin Wall the former Socialist Unity Party of Germany (SED), the ruling party in the communist German Democratic Republic, transformed itself into the Party of Democratic Socialism (PDS) and declared its full acceptance of the constitution of the federal republic. In 2004 the PDS formed an alliance with a splinter group from the SPD, the Electoral Alliance for Work and Justice (WASG), to fight the September 2005 election. In June 2007 the two parties merged as the Left Party.

Far-right parties

The Republicans, the Deutsche Volksunion (DVU) and the National Democratic Party (NPD) represent nationalist forces on the far right and have played on resentment against immigrants. None of these parties has been represented in the Bundestag (the lower house of parliament), and support rates in recent general elections have been well below the 5% minimum threshold. However, they have had some success in entering state parliaments, particularly in eastern Germany, where high unemployment has led to serious disillusionment with the established parties. The Republicans, who are the least extreme of the three, have recently lost some of their support and are no longer represented in any state parliament. The NPD is the most hardline of the three, but an attempt to prohibit the party faltered in 2003, as some witnesses against the NPD were revealed to have been government agents. The DVU and the NPD have some state parliament representation, helped by co-operation between the two.

Main political figures

Angela Merkel (CDU)

The first female chancellor and the first to have been raised in East Germany (although she was born in the west), Ms Merkel had a rapid rise through the ranks of the party. She became leader of the Christian Democratic Union (CDU) in March 2000. Before entering government Ms Merkel repeatedly had difficulties in exercising control over the CDU's regional barons, but her hold on the party has gradually strengthened. Her quiet and conciliatory style has contributed to workable relations with the coalition partner, the Social Democratic Party (SPD), although these are likely to become less good in the run-up to the September 2009 election. She established an international stature when Germany held the presidency of the EU in the first half of 2007 and the presidency of the G8 group of leading industrialised nations throughout 2007.

Frank-Walter Steinmeier (SPD)

The minister of foreign affairs in the coalition, Mr Steinmeier gained extensive experience in foreign policy during his time as head of the chancellor's office during the last years of the government led by Gerhard Schröder. In September 2008 he unexpectedly took over from Kurt Beck as the SPD candidate for chancellor at the 2009 election. A pragmatist, Mr Steinmeier has supported Ms Merkel's efforts to improve relations with the US and is committed to maintaining a reform direction in economic policy.

Franz Müntefering (SPD)

Mr Müntefering withdrew from politics in 2007 for family reasons, but reappeared onto the national stage quite unexpectedly in September 2008 when Mr Beck was ousted. He will be formally appointed as the new chairman of the SPD later in 2008 and will be a central figure in the party's effort to win back support in the run-up to the 2009 election. Mr Müntefering was once known as a traditionalist, but now supports moderate economic reforms.

Oskar Lafontaine (The Left Party)

A former SPD leader and federal minister of finance in the first year of the SPD-Green government under Mr Schröder, Mr Lafontaine left politics in 1999 after losing a power struggle, but returned as a leading figure in the then embryonic Left Party in 2005. A charismatic and populist politician, he has become co-chairman of the newly established party. Mr Lafontaine is a traditional hard leftist and is thus a fierce critic of liberal economic reforms.

Guido Westerwelle (FDP)

Leader of the Free Democratic Party (FDP) since May 2001, Mr Westerwelle had to call off his attempt to reinvent the FDP as a party for the masses of young, fairly apolitical voters, because his "fun party" concept alienated traditional FDP supporters ahead of the 2002 election. He has now returned to the traditional FDP strategy of trying to be at the forefront of economic reform and has managed to regain control over the party.

Horst Köhler (CDU)

Elected president of Germany in May 2004, he was the candidate of the CDU/CSU, which was at the time in opposition. Although a member of the CDU, he had never held major political posts. Previously he was managing director of the IMF and held senior civil service positions in Germany. He has sought to use his office to make the case for reform and, within the constraints of his largely ceremonial post, has not shied away from critical remarks about party politics obstructing vital reforms.

The judiciary The judiciary is independent and respected. The Federal Constitutional Court, based in Karlsruhe, has evolved within five decades into one of the most active and powerful constitutional court in Europe. The Basic Law provides wide scope for judicial review of all legislation. Individual state governments or a defeated minority in the Bundestag, provided it comprises at least one-third of Bundestag members, can challenge a law in the Court. Individuals can also demand an examination of legislation that affects them directly, and lower courts can ask for legislation relevant to a case to be tested by the Court for

compliance with the constitution. If the Court finds a law to be unconstitutional, it can deactivate it, and in special circumstances even replace it with its own rulings. Political parties usually welcome the judicial resolution of sensitive issues such as abortion and whether military forces can be deployed outside the NATO area. The Court has had an important impact on many aspects of policy, including tax legislation, the pension system and fiscal redistribution between states.

The federal legislature

The lower house, the **Bundestag**, is directly elected, with elections at least every four years. It is solely responsible for electing the chancellor. Its electoral system is designed both to provide representative government and to avoid the fragmentation witnessed in the years of the Weimar Republic. Each voter has two votes. The first is used to elect 299 members of the Bundestag from individual constituencies on a first-past-the-post basis, while the second vote is used to determine the overall distribution of the 598 regular seats between the parties, and is therefore more important. If a party wins more seats in the directly elected segment of the vote than the number gained through state party lists, the lower house is enlarged. In the current parliament there are 16 such mandates, leading to a total of 614 seats. To prevent fragmentation, a party must secure three seats in the first-past-the-post system, or 5% of the total vote in order to be entitled to its party list share, which constrains the development of new parties. The constitution makes it difficult to dissolve the Bundestag before the end of its four-year term, but this has happened twice, in 1983 and in 2005. The parliamentary groups of the various parties tend to act in a united manner, although they do not always do so.

The upper house, the **Bundesrat**, is composed of representatives of state governments and must approve certain legislation, including most of the more important bills. Depending on the size of its population, each state government has between three and six votes in the Bundesrat, which must be cast as a block. In the event of coalition partners in state governments disagreeing on the issue at stake in the Bundesrat, they normally abstain. Following state elections in March 2006, the grand coalition has a comfortable majority in the Bundesrat with 44 out of 69 seats (assuming state coalition negotiations following the state elections go as planned), but for previous governments this has often not been the case. Since state elections are held separately during the federal parliamentary term, the political composition of the upper house can change during the term of a federal government, and the government of the day can, and often does, find itself without a majority there. This was singled out as a primary reason for the insufficient pace of reform in Germany. In February 2006 the grand coalition agreed on a reform of the constitution to address this issue, by reducing the number of bills subject to Bundesrat approval. In exchange, the states have been given even greater autonomy on education and the way in which they implement federal legislation.

Media services

About 20 journals have a print run of more than 250,000. Most of the 400 or more daily newspapers have regional rather than nationwide distribution. The main four quality newspapers are the left-leaning *Süddeutsche Zeitung*, the conservative *Frankfurter Allgemeine Zeitung*, the conservative *Die Welt*, and the

leftist *Frankfurter Rundschau*. The leading tabloid *Bild*, the circulation of which is far greater than the four main broad sheets combined, at 3.5m, follows a centre-right editorial line and has considerable political influence. Three weekly publications are also of importance: news magazine, *Der Spiegel*, which has a strong tradition of investigative journalism, *Fokus*, and *Die Zeit*.

A limited amount of advertising is carried by public radio and television companies, which operate under the supervision of the authorities of the individual states. They are financed by a licence fee. A substantial number of private television and radio stations also broadcast. In an important development a media empire, Kirch, collapsed in March 2002. In August 2003 the US billionaire Haim Saban acquired a 72% majority stake in two television channels, ProSieben and Sat.1.

Democracy index (for methodology, see Appendix)

Germany comes 13th in the Economist Intelligence Unit's 2006 democracy index covering 167 countries. This places it in the upper half of the 31 countries considered *full democracies*. It scores highly in terms of *electoral process* and *civil liberties* (although significantly behind Scandinavian countries), fairly high in terms of *political culture* and *government functioning* (the latter including accountability and absence of corruption) and a little less well from the point of view of *political participation*.

Democracy index

	Overall score	Overall rank	Electoral process	Government functioning	Political participation	Political culture	Civil liberties	Regime type
Germany	8.82	13	9.58	8.57	7.78	8.75	9.41	Full democracy

Overall and component scores are on a scale of 0 to 10; overall rank is out of 167 countries.

Recent political developments

- SPD-Greens in coalition 1998-2005.** After 16 years of CDU-FDP government, a strong desire for change and the popularity of the SPD's centrist policies under chancellor candidate, Gerhard Schröder, led to big gains for the party in the general election in September 1998. The SPD formed a coalition government with the Greens, a party with no previous experience in government at the federal level. The left of the SPD remained restive, however, and almost brought the government down in November 2001, when a decision to send German troops to join anti-Taliban forces in Afghanistan was won by just three votes. Despite low opinion poll ratings and faltering economic growth, the SPD-Greens coalition narrowly managed to stay in government after the September 2002 election. The coalition was helped by the personal popularity of Mr Schröder and reservations about his challenger, Edmund Stoiber, an austere Bavarian who stood as chancellor candidate of the CDU/CSU. Mr Schröder's emphatic rejection of German participation in any war against Iraq, in line with the views of the overwhelming majority of the population, also strengthened the SPD.
- Early election in 2005 leads to grand coalition.** The SPD-Green coalition quickly lost electoral support as the economy stagnated, unemployment reached record levels and deep reforms were introduced to place the economy on a more

stable long-term footing. The loss of state elections in February 2005 (Schleswig-Holstein) and May (Nordrhein-Westfalen, the most populous state) so weakened the coalition that Mr Schröder felt compelled to engineer an early election. An intensive campaign allowed the SPD to recover some ground, while tactical mistakes by the CDU and CSU reduced their support substantially. In the end the CDU/CSU received only slightly more votes than the SPD, and neither received a sufficient number of seats to form a coalition with its preferred partner—the FDP and the Greens, respectively. Instead they formed the first grand coalition of CDU/CSU and SPD since the 1960s, headed by Angela Merkel, the leader of the CDU.

- **Coalition functions well in first years.** Despite fierce attacks on each other during the election campaign, the first years of the grand coalition turned out to be quite harmonious. Although differences have since begun to emerge, the coalition has succeeded in introducing a major reform of the federal system, which gives more powers to the states, but reduces the power of the Bundesrat, measures to bring the public finances into balance, and a wide-ranging reform of business and capital income taxation. Ms Merkel has dominated the government seeing off challengers in her own party and emerging as a leading figure on the European stage.

- **Tensions with the SPD cause instability.** Within the SPD divisions widened after entering government with the CDU and one leader after another came and went, reflecting deep differences on the party's strategic direction between modernisers and traditionalists. The party's persistently low poll ratings since the 2005 election and the emergence of the Left Party as the fifth force in German politics served only to deepen divisions. In September 2008 the minister of foreign affairs, Frank-Walter Steinmeier, took over as the party's chancellor candidate for the 2009 general election.

For an analysis of the latest political developments, see the Economist Intelligence Unit's most recent **Germany Country Report**.

Important recent events

September 2005

The Christian Democratic Union/Christian Social Union (CDU/CSU) comes ahead of the Social Democratic Party (SPD) in an early federal election, but with a less decisive victory than had seemed likely when the election was called.

November 2005

A "grand coalition" between the CDU/CSU and SPD, headed by Angela Merkel, leader of the CDU, is formed after difficult negotiations.

February 2006

A constitutional reform put forward by the coalition increases the powers of the states but reduces the number of bills that the Bundesrat (the upper house of parliament), which consists of state government representatives, can veto or amend.

January 2007

A 3-percentage-point increase in value-added tax (VAT) is introduced. Although it further dampens consumer spending, it contributes to achieving the first balanced budget in decades.

January-June 2007

Germany holds the presidency of the EU and succeeds in winning broad agreement from all 27 member states on the basis of a reform treaty at the EU summit on June 22nd-23rd in Brussels. Germany also holds the presidency of the G8 group of leading industrialised nations in 2007.

June 2007

A fifth force in German politics was created with the merging of the Party of Democratic Socialism (PDS) and the Electoral Alliance for Work and Justice (WASG) to form the Left Party.

2008

Public opinion moves sharply against further liberalising reform causing government reform efforts to halt.

August 2008

Russia invades Georgian territory and subsequently announces that it would recognise as independent two ethnically Russian enclaves in that country. The use of force in an inter-state dispute causes wide shock in Germany and across Europe.

September 2008

Frank-Walter Steinmeier is installed as the new leader of the SPD, signalling a victory for the centrist wing of the party.

International relations and defence

- Germany is a member of the EU, the UN, NATO, the OECD, the Organisation for Security and Co-operation in Europe (OSCE), the Council of Europe, the IMF and the World Bank. German foreign policy over the past 50 years has had a strongly multilateral quality, and its main external policy concerns have been handled through the EU and NATO. Germany's commitment to these institutions remained intact after reunification, although it has been criticised by the US for not making a greater contribution to the NATO force in Afghanistan.
- Germany backed the proposal for a single European currency, introduced in 1999, partly to allay French concerns about a reunified Germany, but also because the German chancellor at the time of the decision, Mr Kohl, believed that the ties of a common currency would make a return to military conflict between the participants unthinkable. Mr Schröder was more pragmatic in relation to the EU but Ms Merkel has given high priority to trying to strengthen the EU, although the success of her efforts have been put into question by the June 2008 defeat of the Lisbon treaty in a referendum in Ireland.
- The Franco-German axis has been an important motor of European integration, not least because in the past France and Germany represented a wide range of views held among member states, so that any compromise

between the two stood a good chance of being accepted by other EU members. Given much expanded membership and increased diversity in the EU, it has become more difficult for the two countries to play this role and relations between Ms Merkel and the French president, Nicolas Sarkozy, are not as close as relations between previous German and French heads of government.

- Germany was a strong advocate of the EU accession of ten countries mainly in central and eastern Europe in May 2004 and backed the accession of Romania and Bulgaria in 2007. However, there has been concern in Germany over migration from the new member states, which will be restricted until 2011, and over tax competition, particularly corporation tax. The SPD supports Turkish EU accession, while the CDU/CSU, and a majority of the electorate, are against. The coalition government has taken a constructive approach to continuing accession negotiations while being non-committal over eventual accession, which is in any case not feasible until around 2015. Germany's relations with its central European neighbours—Hungary, Poland and the Czech Republic—are generally close. Relations with Poland and the Czech Republic exhibit occasional tensions, with historical issues playing an important role.

- Since shortly after the second world war the US has been Germany's leading ally, not least because it played a decisive role in deterring a Soviet invasion during the cold war. The disappearance of Soviet control of eastern Europe and of the Soviet Union itself in 1991 led to substantial differences in thinking about major global threats and the ways to avert them, leading to more sceptical attitudes among many Germans towards the US. This came to the fore in 2002 and early 2003, when the SPD-Greens government strongly opposed the US's plan to attack Iraq and Mr Schröder used popular resentment against the US plans to further his election campaign, which resulted in a serious deterioration in German-US relations. There has been a substantial improvement in relations since November 2005, when the former SPD-Greens coalition was replaced by a CDU/CSU-SPD coalition led by Ms Merkel, who supported the US on Iraq.

- Relations with an increasingly assertive and often aggressive Russia have become increasingly central to German foreign policy in recent years. Both the previous SPD-Greens government and the current CDU/CSU-SPD government have made efforts to build relations with Russia, but Ms Merkel has been willing to temper this aim with more criticism of Russia on human rights and has also shown awareness of the need for a degree of solidarity with new EU member states, whose relations with Russia are often strained. Russia's invasion of Georgia in August 2008 amounted to a step change in Russia's foreign posture and raises new security concerns for Germany.

- In response to the end of the East-West confrontation, Germany's armed forces have been drastically reduced over the last decade. The overall number of forces fell from 550,000 in October 1990 to 248,000 in November 2005. Although conscription of able young men is still the principle, the requirements of the military are so low that a substantial share of those available for service are not actually drafted. Many young men opt for alternative civil service, providing important support for healthcare and social services. In April 2006 there were 66,243 men in this position. There have been repeated discussions

about the abolition of conscription, but the CDU/CSU continues firmly to back conscription, and the majority of the SPD favours its continuation, while the FDP and the Greens have campaigned for its abolition. The reduction in troops has been matched by a large cut in the defence budget, to €23.8bn, or just 1.1% of GDP (excluding military pensions) in 2005. Weak defence spending has led to criticism from the US and NATO that Germany's capacity for international intervention is insufficient.

- Although the number of foreign troops on German soil has been substantially reduced since reunification, in 2005 there were still 69,790 US armed forces personnel stationed in Germany, plus 22,000 from the UK, 3,200 from France and 2,600 from the Netherlands.

Demographics and resources

Population

Population

	2003	2004	2005	2006	2007
Population (m)	82.5	82.5	82.5	82.5	82.6
Population (% change)	0.0	0.0	0.0	0.0	0.1

Source: US Census Bureau.

- **The population will shrink.** According to the US census bureau, Germany's population stood as 82.6m in 2007. Demographic projections by the Federal Statistics Office from 2006 suggest a decline of the population to 72m by 2050, as the fertility rate remains well below the replacement ratio and net immigration is low. As with most other developed economies (and some less developed ones), the population is ageing rapidly as a result of greater longevity and low fertility rates. The ratio of the elderly population (people over 65 years) to the working-age population (20-64 years) is forecast to increase substantially from 32% in 2005 to 62% in 2050, exerting huge strains on the social security system.
- **Immigration has declined.** According to national sources, there were 6.7m citizens of other countries resident in Germany. After reaching a peak in 1992, at 790,000, net immigration declined steeply to stand at just 44,000 in 2007. The influx of ethnic Germans from eastern Europe had risen after the fall of communism, but this flow dried up in the late 1990s. Ethnic Germans living abroad (*Aussiedler*) are guaranteed citizenship. The tightening of asylum rules approved in early 1993 also led to a substantial reduction in immigration. A new Immigration Law took effect at the beginning of 2005, modernising the antiquated German immigration system. The law facilitates immigration for highly qualified non-EU citizens such as engineers and academics, although it has not had a substantial impact on overall immigration numbers. People with mid-range qualifications can obtain a limited permit, but only if they have been offered a job that could not be filled by an EU citizen. Immigration within the 15 EU states whose membership predates 2004 is unrestricted, but immigration from the 12 member states that joined in 2004 and 2007 remains subject to transitional restrictions, which can be imposed for a maximum period of seven years.

- **Foreign population is long-established.** The majority of Germany's foreign population consists of migrants who arrived in the 1950s and 1960s and their descendants (not all descendants have taken German nationality). Many of these are from outside the EU, including 1.7m Turkish citizens, of whom about 500,000 are Kurds. Although gaining German citizenship has been made easier, adult applicants need to give up their original citizenship, and there is often a reluctance to abandon links with the mother country. Data from the Federal Statistics Office show the total population with a migration background (migrants and their offspring) to be 15.1m, of whom 8.4m have become German citizens. The social and economic status of the population with a migration background continues to be below average, resulting from low job qualifications, badly paid jobs and high unemployment rates. More than 51% of the group with a migration background are without a training qualification, compared with 27% of the population without a migration background. An increasing awareness of social problems caused by the exclusion of immigrant groups has led to a greater focus on the integration of immigrants.

Education

Education is provided by the 16 states and the local authorities. Following the implementation of a package of constitutional reforms, effective since September 2006, the federal government now has a direct influence only on the apprenticeship system.

Private provision of schooling is only of limited importance. Compulsory schooling normally begins at the age of six. After four or six years of primary education, pupils transfer to one of four types of secondary schools. The *Hauptschule* provides a secondary education lasting up to the ninth year of schooling and emphasises practical subjects in the final years in order to prepare students for employment in the manual trades; *Realschulen* prepare students for technical or commercial employment lasting up to the tenth year of schooling; while *Gymnasien* (grammar schools), lasting up to the 12th or 13th year of schooling, are for academically inclined pupils. In the early 1980s a large number of *Gesamtschulen* (comprehensive schools grouping together the three types of education) were established, particularly in states governed by the Social Democratic Party (SPD). This trend has been partially reversed where the Christian Democratic Union/Christian Social Union (CDU/CSU) has gained control of previously SPD-governed states.

The quality of German secondary school education was called into question by the OECD's Programme for International Student Assessment (PISA) study of 15-year-olds in 32 countries. The first round, for which results were published in December 2001, showed the performance of German pupils in the bottom 25%. The second and third rounds, conducted in 2003 and 2006 respectively, showed gradual improvement, with German pupils slightly above average in science tests and at the OECD average in reading and mathematics. The studies revealed that the German school system was unusually bad in overcoming class barriers. The results came as a shock to the German school system and started a major debate about the need for reform towards more equity and efficiency. The states are still working on a response, but major changes do not seem likely.

as teachers, an important constituency, are reluctant to endorse change and middle-class parents will resist changes that might lower the quality of their own children's education by giving more emphasis to less privileged children.

Tertiary education is available at general and technical universities, and at the less academic *Fachhochschulen*. Standard degree courses last a minimum of four-and-a-half years. Many students take longer to complete their studies, partly because they have to fund themselves by combining work and study. As a result of the length of courses the typical graduation age is high, at 25-26 years, substantially above that in most other European countries. In order to accelerate the progress of graduates towards the labour market, bachelor degree courses lasting only three years are being introduced.

The vast majority of universities are public institutions, where tuition is free or charged at a nominal sum, but since the Constitutional Court ruled in January 2005 that the states have the right to introduce tuition fees, six of the ten western states (all under CDU governments) currently levy fees of €500 per semester. These fees may help to improve the dire financial situation of many German universities, although some states may simply reduce their funding for universities to consolidate their own budgets. At the same time, banks and official institutions are increasingly offering student loans.

Natural resources

Germany's primary natural resource is coal, both hard coal and lignite. There are no other significant energy resources. Other minerals include potash, of which the former East Germany was a major producer, and small quantities of rare minerals, including uranium, cobalt, bismuth and antimony, mined in the Erzgebirge along the southern border with the Czech Republic. Overall, metallic mineral resources are insignificant.

Two great rivers—the Rhine, which runs south to north in the west of the country, and the Elbe, which flows from the Czech Republic to the sea at the port of Hamburg—have traditionally played an important role as waterways within and beyond Germany. There is now also a canal linking the Rhine via its tributary, the Main, with the Danube, which originates in Germany and flows through Austria to the Black Sea.

Infrastructure

Germany has a modern, comprehensive transport infrastructure. The transport network in the eastern states has gone through a massive upgrade following reunification in 1990.

Railways The railway system is extensive and of a high standard, but passenger travel is quite costly. In 2007 the number of passenger rail journeys amounted to 2.2bn, and the volume of goods transported by rail equalled 361m tonnes. The railway market has been liberalised cautiously. Track is managed by DB Netz, a subsidiary of the former monopolist, Deutsche Bahn (DB). DB Netz charges all carriers, DB as well as its competitors. Since January 2006 DB is supervised by

the new Federal Network Agency, which is in charge not only of securing fair conditions for third-party access to the railway network to foster competition, but also of approving the pricing structures of dominant players to prevent the abuse of market power. So far, competition is marginal and the partial privatisation of DB, scheduled for late 2008, is expected to have only marginal effects on competition as DB will continue to be in charge of managing the railway network.

Roads In 2007 the total length of roads, excluding streets in cities and villages, was 231,400 km. Of these, 12,500 km were motorways (*Autobahnen*). The introduction of an automatic toll system for lorries came into operation in January 2005. Under the system lorries on motorways are charged on average 13.5 euro cents/km since 2007, and the revenue of more than €3bn per year is mainly to be used to finance the repair and maintenance of existing motorways. There is currently no plan to introduce a similar system for passenger cars, but the fee for lorries shall be increased substantially to on average 16.3 euro cents/km from 2009 on.

Ports Freight traffic through seaports in 2007 totalled 311m tonnes. At the end of 2006 the sea-going merchant fleet was 11.6m gross registered tonnes, up from 6.1m in 2003. The most important port for Germany is Rotterdam in the Netherlands. Hamburg, by far the largest domestic port, accounts for about 38% of all freight shipped from German ports. Bremen/Bremerhaven, Wilhelmshaven, Lübeck and Rostock are the other major freight terminals.

Air transport In 2007 a total of 164m passengers were carried by commercial air services. The busiest airport in terms of aircraft movements, passengers embarked and freight traffic is the Rhein-Main Airport outside Frankfurt am Main, which accounted for 29.7% of all passenger traffic in 2006. Munich is the second-busiest in terms of passenger traffic, and Cologne-Bonn is the second-busiest in terms of freight traffic. Other major passenger airports are Berlin-Tegel, Düsseldorf and Hamburg. The federal government and cities such as Berlin and Cologne are preparing to sell their shareholdings in airports. Frankfurt airport was listed on the stock exchange in May 2001 as the Fraport Company. The most important airline continues to be Lufthansa, but in 2004 its share shrank to about one-third of the market. The main national competitors are Air Berlin and the co-operation of Deutsche BA and LTU, established in March 2006. Foreign low-cost airlines also play a role, their market share (measured by the number of passengers) having grown more than fivefold since 2001 to reach 26% in 2007.

Energy Germany imports around three-fourths of its primary energy requirements, including almost all of its oil, which accounted for 35% of primary energy consumption in 2006, while natural gas accounted for 23%, hard coal for 13%, lignite for 11% and nuclear energy for 13%. Other sources, including renewable energy sources, accounted for only 6% of primary energy consumption. Renewable energy production is, however, showing strong growth, not least as a result of heavy subsidies. Biomass and wind production dominate.

In June 2001 the coalition government of the SPD and the Greens and the power-generating companies agreed a programmed gradual withdrawal from nuclear power, which currently provides 22% of German electricity production. Under the scheme the last of Germany's 17 nuclear power stations would be taken off the grid by around 2020. Finding alternative electricity sources will pose a considerable challenge. The emphasis is being put on the construction of gas-fired generators. Renewable energy is also being developed and is heavily subsidised, but there is little prospect of it contributing in any major way towards replacing nuclear electricity.

Ironically, Germany might have to rely more on substantial imports of nuclear energy from France. The general difficulty of building replacement plants and the sharp recent rise in the cost of alternative energy sources (gas and coal) may lead the current or any subsequent government to extend the operating times of nuclear stations. The case for this has been strengthened by concerns that the decommissioning will make it more difficult to meet targets on greenhouse gas emissions and that the supply of natural gas, particularly from Russia, may not be reliable in the long term. The CDU/CSU is clearly in favour of an extension, but the SPD wants to stick to the current programme. The construction of new nuclear plants, however, is unlikely. Germany pays significant subsidies to hard coal and lignite producers, which are gradually being reduced under pressure from the European Commission.

State and municipal governments participate in local energy utilities, while large private-sector companies predominate at generation and inter-regional supply levels. Although around 900 local—predominantly municipal—utilities are in operation, dense cross-shareholdings sustain a vertically integrated structure of provision. German electricity and gas prices used to be among the highest in the EU, but electricity prices fell substantially after the liberalisation of the electricity market in April 1998, when Germany implemented EU liberalisation directives ahead of many other countries. There are four major players in the electricity supply sector: RWE; E.on; EnBW, in which Electricité de France has a substantial minority stake; and the German subsidiary of Swedish energy company, Vattenfall. Restructuring continues in the gas sector, as electricity companies have bought up regional gas distributors. By far the most important of the deals was the acquisition of Ruhrgas, the supplier of 75% of Germany's natural gas imports, by E.on. After the Federal Cartel Office had refused the proposed merger, the government decided to approve it, arguing that Germany needs a strong energy company to secure long-term supplies.

Initially, Germany relied on negotiated third-party access (nTPA) to networks by competing suppliers, but this proved to be unsatisfactory, and in July 2005 the Federal Network Agency, formerly the Regulatory Agency for Post and Telecommunications (RegTP), took charge of regulating network access fees in the gas and electricity markets. It is hoped that this will stimulate competition in the medium term. The Federal Network Agency has admonished RWE for excessive electricity prices in 2005 and is currently leading an investigation in conjunction with the European Commission to determine whether it has colluded with E.ON, Vattenfall and EnBW. As a reaction to the tightened regulation and to avoid further investigations, E.on announced plans to sell-off

its long-distance high-voltage network in early 2008 and Vattenfall followed suit later in the same year.

Telecommunications Radical changes in the regulatory regimes governing communications utilities were put in place during the 1990s, and the sector is still subject to regulatory change. Until January 1998 Deutsche Telekom (DT) held the monopoly on fixed handset voice transmission, which was then liberalised under EU legislation. DT has been largely privatised. Minority shareholdings in DT's Internet service provider, T-Online, which had been floated on the stock exchange, were repurchased by DT in 2005. DT continues to dominate the fixed-line market, although the relative importance of this market segment has declined.

For more information on the telecommunications sector, see the Economist Intelligence Unit's most recent *Telecoms and Technology Industry Briefing* for Germany.

The economy

Economic structure

Real gross domestic product by sector (% share of GDP)

	2003	2004	2005	2006	2007
Agriculture	1.0	1.1	0.9	0.9	0.9
Industry	28.9	29.1	28.9	29.4	30.1
Services	70.1	69.8	70.2	69.8	69.0

Source: Economist Intelligence Unit.

More than in most other advanced economies, manufacturing and related services are still at the heart of the German economy. The share of industry, excluding construction, in total gross value added actually increased from 25.3% in 1998 to 26.4% in 2007. The main manufacturing industries are the industrial machinery, automotive and chemical industries, while telecommunications has also become a sector of great importance. The steelmaking sector in the Ruhr region has declined sharply, and agriculture has become a sector of only marginal importance for the economy as a whole. As in other industrialised economies, the importance of services has increased substantially, accounting for 69% of gross value added in 2007.

On the expenditure side, the components of German economic growth are in large part in line with the average in other developed economies. Private consumption, which is by far the largest component, accounted for 57% of GDP in 2007, identical to the euro area average. The two other principle components of domestic demand—public consumption and fixed capital formation—both account for about 18% of GDP, 3 percentage points below the euro area average (in both cases). The former has shrunk as public spending growth has been squeezed, while the latter is lower than the euro area average because of the low level of investment in property in Germany (and the unsustainably high levels of the same in some other countries in the currency bloc). By contrast, exports have come to account for a much larger share of output in recent years

as the country has risen to become the largest exporter in the world. Compared with the euro area average of 41% (and an OECD average of 27%), exports accounted for 47% of GDP in Germany in 2007.

Nominal gross domestic product by expenditure

(% share of GDP)

	2003	2004	2005	2006	2007
Private consumption	59.4	59.1	59.1	58.5	56.7
Government consumption	19.3	18.8	18.8	18.3	18.0
Gross fixed investment	17.9	17.5	17.4	18.0	18.5
Stockbuilding	-0.5	-0.5	-0.3	-0.2	-0.2
Exports of goods & services	35.6	38.3	40.9	45.1	46.7
Imports of goods & services	31.7	33.3	35.8	39.6	39.7

Source: Central Statistical Office.

Economic policy

Like most European countries, West Germany began deficit financing in the 1970s as the protracted post-war expansion turned to recession. The result was in the generation of a substantial stock of public debt. During the downturn of the early 1980s, deficits were run again, adding to the debt stock. By the beginning of the 1990s, the debt:GDP ratio stood at 40%, higher than either France or the UK. The large costs associated with the reunification of the country, followed by the downturn of the early 1990s, saw a fresh wave of deficit financing, pushing public debt to over 60% of GDP in 1996. Deficits narrowed in the late 1990s and the debt ratio stabilised. However, as in each previous downturn over three decades, the growth slump from 2000 saw deficits return, a development that took place despite the limit on deficits of 3% of GDP for participants in economic and monetary union (EMU), and as set out in the Stability and Growth Pact. As a result of these high budget deficits, government debt increased to 67.8% of GDP in 2005. In 2006 and 2007 strong economic growth, higher tax rates and curbs on spending resulted in a slight general government surplus in 2007. The government's most recent stability programme aims to continue the process of fiscal consolidation.

The SPD-Greens government passed several major tax reform packages between 1998 and 2005. Implementation of the most important of these—a reduction of income tax rates—was completed in 2005, with the top rate of personal income tax falling from 53% in 2000 to 42% in 2005. However, the current CDU-SPD government partially reversed this, raising the top rate in 2007 to 45% for individuals with annual incomes above €250,000. On top of this, a "Solidarity Tax" will continue to be used to pay for the cost of reunification, which adds 5.5% to the normal income tax bill. Consequently, the overall top income tax rate is now 47.5%. From 2009 onwards a comprehensive final withholding tax for all capital income (such as dividends, interest, and capital gains) will be introduced at a general rate of 25% (26.4% including solidarity tax). While this represents a big reduction of tax rates for capital income compared with the current regulations, the tax base for capital income will be broadened by the inclusion of capital gains, which are at present largely tax free.

From 2008 the headline rate of corporation tax was cut from 25% to 15%, reducing the combined rates of corporation tax, local trade tax and the Solidarity Tax from 38.65% to 29.8%. This brought headline tax rates on business profits in Germany close to the level in the UK and below that in the US. However, as the rate cuts were largely financed by broadening the tax base, the amount that the average firm pays was reduced by less (according to the OECD, the effective average tax rate fell by 4 percentage points, whereas the Centre for European Economic Research calculated a bigger effective reduction, of 8.5 percentage points).

The government will need to reform the inheritance tax by the end of 2008, following a ruling by the Constitutional Court in January 2007 that different valuation schemes for real estate compared with other assets violated the principle of non-discrimination enshrined in the German constitution. The minister of finance, Peer Steinbrück, plans to make the requirements of the ruling part of a general reform of the inheritance tax, which will reduce the tax levied on medium-sized family businesses, in particular. The main rate of value-added tax (VAT) was increased from 16% to 19% at the beginning of 2007.

Money supply

(€ bn unless otherwise indicated)

	2003	2004	2005	2006	2007
Stock of domestic credit	3,043	3,046	3,051	3,048	3,028
Domestic credit growth (%)	-0.3	0.1	0.1	-0.1	-0.7
M1 (% change, year on year)	8.9	5.3	11.1	5.4	4.0
M2 (% change, year on year)	3.4	3.5	4.2	5.5	8.0

Source: IMF, *International Financial Statistics*.

Monetary policy is now in the hands of the European Central Bank (ECB), which was formally created in June 1998 and took full control of monetary policy in January 1999. The ECB aims to set interest rates to keep inflation, in terms of the euro area's harmonised index of consumer prices, at "close to but below 2%". In December 2005 the ECB embarked on a tightening cycle. Based on increasing evidence of a cyclical recovery, rates were raised again in June 2007 to 4% and in July 2008 to 4.25%. There has been concern in Germany that ECB policy, based as it is on economic conditions in the euro area as a whole, which have tended to be more favourable than in Germany, has proved to be overly restrictive for the country. However, it is unlikely that overall monetary conditions would have been much more favourable under an independent central bank, as the D-mark might have appreciated more strongly.

Interest rates

(%)

	2003	2004	2005	2006	2007
Lending interest rate	9.1	8.8	8.8	9.2	9.8
Deposit interest rate	2.2	1.9	1.9	2.6	3.1
Money-market interest rate	2.3	2.1	2.2	3.1	4.3

Sources: IMF, *International Financial Statistics*.

For an analysis of the latest economic policy developments, see the Economist Intelligence Unit's most recent **Germany Country Report**.

Economic performance

Main economic indicators

	2003	2004	2005	2006	2007
Real GDP growth (%)	-0.2	1.1	0.8	2.9	2.5
Consumer price inflation (av; %)	1.1	1.7	1.5	1.6	2.3
Current-account balance (US\$ bn)	53	130	148	181	255
Exchange rate (av; €:US\$)	0.9	0.8	0.8	0.8	0.7
Population (m)	82.5	82.5	82.5	82.5	82.6

Source: Economist Intelligence Unit, *CountryData*.

Economic progress up to German reunification in 1990 falls into three periods: first, the reconstruction of the 1950s, with generous US assistance, which brought the country back into the ranks of the Western industrialised powers; second, the 1960s, marked by expansion and modernisation; and third, the period after the oil crises of 1973-74 and 1979-80, when growth slowed. Reunification on October 3rd 1990 added a strong stimulus at a time when the west German economy was already experiencing a cyclical boom. Massive transfers from western Germany to finance an upgrading of infrastructure and generous tax incentives for private investors also created a building boom. The surge in economic activity around the time of reunification led to a huge strain on capacity, which was shown by the fact that the traditional current-account surplus swung into deficit and by a sharp rise in inflation. A deep recession followed, with the economy contracting in 1993.

The remainder of the 1990s saw solid rates of growth registered, peaking in 2000. From 2001-05 Germany suffered its lowest period of economic growth in the post-war period, with feeble domestic demand accounting for the near-stagnation. By contrast, the global economic upturn triggered an export boom. In 2006 domestic demand started to recover; coupled with the positive effect of strong export growth, GDP grew by 2.9%—the strongest rate since 2000. In 2007 the expansion of the German economy continued at the slightly lower pace of 2.5%.

Agriculture Although agriculture, forestry and fishing accounts for only 1% of gross value added, the sector still plays a significant role in the social fabric of parts of the country. Germany is about 70% self-sufficient in food. The agricultural trade deficit was €10.2bn in 2006.

Agricultural structures differ considerably between regions, and particularly between east and west. Whereas family-run farms predominate in western Germany, larger agricultural companies, which emerged out of socialist agricultural collectives, are a typical feature of agriculture in eastern Germany. Consequently, 93% of agricultural land in eastern Germany is used by farms of more than 100 ha (2005 data). The average farm size is 188.2 ha, compared with only 31.2 ha in western Germany (2005 data). The share of organic farming has increased strongly, from 3% in 1999 to 4.6% of all agricultural land in 2005, reflecting public subsidies as well as increasing domestic demand for ecological products.

Mining In 1996 hard coal and lignite mining still employed 138,000 workers in western Germany and 26,000 in eastern Germany, but the total number fell to 57,000 in 2005. Output of hard coal has fallen sharply, from 66m tonnes in 1991 to 20.9m

tonnes in 2006. Most importantly, the decline in hard coal output reflects high production costs, which in 2005 were three to four times the cost of imported coal, as well as falling levels of public subsidy, driven both by the deterioration in the public finances and by pressure from the European Commission. Under a decision by the government reached in November 2003, production is to be cut to 16m tonnes per year by 2012, when subsidies will fall to €1.83bn.

Production of lignite fell from 357m tonnes in 1990 to 161m tonnes in 1999, before rising slightly to around 180m in 2003 and fluctuating around this level in 2004 and 2005. In 2006 176.5m tonnes of lignite were produced. Germany is unusual among industrialised countries in that it relies much more on lignite than on hard coal for the purpose of electricity generation. Unlike hard coal, lignite is not subsidised. Deposits in Germany are on the surface, so that production is much cheaper than hard-coal mining. Crude oil production, at 3.5m tonnes per year in 2006, was only marginal compared with imports totalling 112.2m tonnes. Production of natural gas amounted to 180.2bn kwh equivalent in 2006, compared with imports of 909bn kwh (2003 data).

Industry Although GDP data show that manufacturing is now much smaller in terms of value added than the services sector as a whole, it is still the backbone of the economy. Many service companies are linked in one way or another to manufacturing activity. In 2007 industry (defined as manufacturing, mining, electricity, gas and water) accounted for 26.4% of gross value added.

As might be expected of the world's third-largest economy, almost the entire range of industrial goods is produced, but Germany's industrial strengths lie in vehicles, capital goods, chemicals and household equipment. Output and exports include a smaller proportion of high-tech products than in other leading industrialised countries because of Germany's less developed aerospace and computer hardware industries. Although the country has many internationally known manufacturing companies, the *Mittelstand* of medium-sized companies is widely considered to be the backbone of the sector and of the economy as a whole. Typically, these companies have fewer than 500 employees; they are usually family-owned and are present throughout the western states.

Industrial production

(% change, year on year)

	2003	2004	2005	2006	2007
Industrial production	0.4	3.0	3.3	5.9	6.1

Source: Central Statistical Organisation.

In the eastern states the main manufacturing sectors are electrical engineering and electronics, chemicals, vehicles, and glass and ceramics. Most former east German industry has been closed down since reunification, but there have been some major new investments by both large and medium-sized western German and foreign companies. Major greenfield investment by Volkswagen, Opel and BMW (car production), Daimler-Benz (trucks), and Siemens and AMD (semiconductors) is of strategic importance. However, these industries are highly capital-intensive and provide limited employment opportunities. Nevertheless, there has been a profusion of start-up companies, particularly around the new high-tech centres of Dresden and Jena, while in other regions, such as

the area around Frankfurt/Oder, attempts to attract high-tech investors have largely failed.

Construction grew vigorously in 1989-95. Demand for housing in the western states was particularly strong from migrants from the new eastern states and elsewhere, and in the eastern states public works and private building activity boosted by special tax concessions burgeoned. However, between 1996 and 2005 construction investment declined by 24.7% in real terms. As a result of the economic upswing, construction recovered a little and real construction investment increased by 5% in 2006 and 1.9% in 2007.

Housing oversupply is still a problem in eastern Germany, as slow migration towards western Germany continues. Annual investment in housing is gradually normalising and stood at around 5% of GDP in 2007, down from the peak of 8% of GDP in 1994 and lower than the OECD average. Non-housing construction investment fell in the first half of the current decade, owing to efforts to make the public finances more sustainable, but it has recovered since 2006.

Services The banking sector is divided into three main groups: private-sector commercial banks, co-operative banks and public-sector banks (*Landesbanken* and savings banks). In the public sector, which is the most important in terms of overall balance sheets, savings banks are organised regionally and co-ordinated by the *Landesbanken*. Public-sector and co-operative banks dominate the retail market, including company financing for small and medium-sized companies. The biggest of the commercial banks are Deutsche Bank, followed by Commerzbank, and HypoVereinsbank (HVB). In 2005 banking consolidation in Germany made substantial progress. Commerzbank, formerly the smallest of the leading German banks, took over Eurohypo, a bank specialised in mortgage financing, and became the second-largest German bank. In 2008 Commerzbank acquired Dresdner Bank. Although Commerzbank now has the highest number of branches in Germany (1,540, compared with Deutsche Bank's 986), it still has only half the balance sheet total of Deutsche Bank. HVB merged with the biggest Italian bank, Unicredito (in effect a takeover by Unicredito) and became the third-biggest bank.

Of the public-sector banks, the Bayerische Landesbank and the Westdeutsche Landesbank have significant operations at the national level. During the 1990s the Westdeutsche Landesbank (WestLB) moved into investment banking. Historically, *Landesbanken* benefited from public guarantees that improved their ratings and thus their access to financing. Following an investigation by the European Commission's competition directorate, the guarantees were removed in mid-2005, which greatly increased pressure on these banks. As a result consolidation is currently underway, leading to the creation of the Landesbank Hessen-Thüringen (Helaba) and HSH Nordbank, formed as a result of the merger of the state banks of Hamburg and Schleswig-Holstein. The Landesbank Rheinland-Pfalz (LRP) has become a subsidiary of the Landesbank Baden-Württemberg (LBBW). Further consolidation of the *Landesbanken* and among the large number of savings and co-operative banks is ongoing. In June 2007 the state of Berlin sold its majority stake in Landesbank Berlin to the national association of saving banks. As a result of the US sub-prime crisis, the state bank

of Saxony, SachsenLB, and WestLB suffered large losses. SachsenLB was sold to LBBW and WestLB is currently being restructured.

A characteristic feature of the economy is the great importance traditionally attached to long-term bank credits as the predominant form of company financing. This feature is partly the result of the structure of German industry, as the majority of the *Mittelstand*—the medium-sized companies that form the backbone of the economy—are too small to have access to direct capital market financing at acceptable costs. Also, until recently, intense competition among banks, the strong presence of public-sector banks with little incentive to maximise profits, and high domestic savings meant that the costs of financing via bank loans were low in an international comparison. However, this has changed as public-sector banks are putting a greater focus on profitability. This has increased the importance of direct capital market access, but bank financing is still by far the most important form of financing.

Overall insurance premium income amounted to €162.9bn in 2007, according to the German insurance association, the Gesamtverband der Deutschen Versicherungswirtschaft (GDV). Germany has several large insurance companies that are also important international players. Foremost among these are Allianz, with its traditional focus on life insurance, and Munich Re, primarily a reinsurance company.

Germany's financial markets are dominated by the Deutsche Börse in Frankfurt, although there are several much smaller regional exchanges. Traditionally, equity used to be more a vehicle of control than for raising finance, and in the past cross-shareholdings among companies accounted for 25% of all shares held. At the end of the 1990s share issues became more important, as the equity boom led to a sharp drop in equity financing costs. Overall, market capitalisation in Germany remains small relative to the size of the economy. In July 2008 the domestic equity market capitalisation of the Deutsche Börse amounted to US\$1.76trn, according to the World Federation of Securities Exchanges. This compares with US\$3.17trn for the London Stock Exchange, US\$1.61trn for the Spanish Exchanges (BME) and US\$1.16trn for the Swiss Exchange (SWX). The relatively small German market capitalisation partly reflects the industrial structure of Germany. Specifically, Germany has a high proportion of small and medium-sized companies, which because of their size have not sought access to stockmarkets.

In 2004 the retail trade was an important subsector and provided employment for 2.6m people, of whom 26.6% worked in food retailing. A total of 274,194 enterprises were active in this field, although most of them were small. The food retail market, in particular, is dominated by large chains operating in conditions of tough competition. Concentration is also taking place in non-food retailing, as many of the specialised small high-street shops have been forced to close down because of fierce competition from larger chains. Mail order, and particularly e-commerce, is also important.

Tourism is a significant sector. In 2007 some 24.4m foreigners visited Germany for business or pleasure, and 19.8m Germans booked vacations involving stays of more than four nights in Germany. In 2007 the number of overnight stays

reached a new record level of 361.8m. According to balance-of-payments data, Germany earned €26.1bn from foreign visitors in 2006, and total turnover in the hotel and restaurant industry was €33.7bn (down from €42bn in 2001). The most important tourism areas in the west are Bavaria, Baden-Württemberg and the Rhine valley, while Berlin, Dresden, Thüringen and the Harz mountains top the list in the east. Hannover, the home of Cebit, the world's most important information technology (IT) fair, and Frankfurt are both particularly important business destinations, not least because of their trade fairs.

Employment trends

In the late 1980s West Germany, helped by an excellent training system, had one of the lowest unemployment rates in the EU, but reunification changed the situation. The excessively rapid convergence of east German wages towards west German levels led to a sharp loss of competitiveness among eastern workers and to the collapse of a large share of east German industry. The unemployment rate in eastern Germany (national definition based on registered unemployment) was still 15% in 2007. The costs of reunification and weak growth also contributed to a surge in west German unemployment. In recent years employment has been growing strongly and the rate of unemployment reached fell from 11.7% in 2005, to 9% in 2007.

Employment

	2003	2004	2005	2006	2007
Labour force (m)	43.1	43.3	43.7	43.6	43.5
Unemployment rate (%)	10.5	10.6	11.7	10.8	9.0

Source: UN, *FAO Yearbook*; World Bank, *World Development Indicators*; Financial & Economic Research International.

The last government under Gerhard Schröder (1998-2005) made a number of labour market reforms. In 2001 it tightened conditions for people registering as unemployed through the introduction of the Active Employment Promotion Law (*Job-AQTIV Gesetz*). Following proposals of the Hartz commission, named after its chairman, the former Volkswagen personnel director, Peter Hartz, the government in 2002 approved legislation to encourage temporary employment. Under Agenda 2010, a reform package launched in March 2003, important further reform steps were approved: entitlement periods for unemployment benefit were shortened with effect from 2006, benefits for the long-term unemployed were reduced from 2005, and conditions for receiving these benefits were also tightened. This was accompanied by a cautious easing of employment protection legislation. Non-wage labour costs of the health insurance system were slightly reduced as a result of a major health reform.

Prices and earnings

Prices and earnings

(% change, year on year)

	2003	2004	2005	2006	2007
Consumer prices (av)	1.1	1.7	1.5	1.6	2.3
Average nominal wages	2.0	0.1	0.6	1.3	0.9
Average real wages	0.9	-1.6	-0.9	-0.3	-1.3
Unit labour costs	20.0	10.0	-1.1	-0.6	9.9

Source: Economist Intelligence Unit.

Apart from temporary price rises after the oil crises of the 1970s, Germany has a strong track record on price stability. There was an upsurge in 1992, when strong demand and the accompanying wage pressures generated inflation of 5.1%. The trend over the remainder of the 1990s was gradually downward until the end of the decade. Rising oil prices from late 1999, amplified by the weak euro, fed through to prices in 2000, and after easing at the end of 2000, the inflation rate climbed again in early 2001 to peak at over 2%. Thereafter it remained below 2% (the ECB's definition of price stability) until recently, when commodities soared internationally, pushing inflation up to 2.3% in 2007 and close to 4% in mid-2008.

Moderate two-year wage agreements concluded in early 2000 helped to prevent any follow-through from the rise in inflation caused by higher import and food prices in 2001. Wage settlements concluded in 2002, again mostly for two years, were slightly higher than before, but between 2003 and 2006 they were again moderate, reflecting still fragile business conditions and the weakening of the trade unions. In addition, wage drift turned negative in 2003, as companies cut payments given in addition to collectively agreed wages (such as separate payments at Christmas). Wage growth slowed from 2.8% in 1999 to below 1% in 2005, which led to a reduction in real terms in 2004 and 2005. Despite the strong economic growth and decreasing unemployment, increases remained low, at 1.3% in 2006 and 0.9% in 2007. Only in 2008 did wage growth pick up somewhat, with increases of 2.2% year on year during the first six months. Although in practice wages are slightly lower in the east than in the west, average unit labour costs in eastern Germany are still some 20% above the western level because of lower productivity.

For an analysis of the latest economic performance data, see the Economist Intelligence Unit's most recent **Germany Country Report**.

Comparative economic indicators, 2007

	Germany ^a	France ^a	UK ^b	US ^b	Japan ^a
GDP (US\$ bn)	3,322.1 ^b	2,556.7 ^b	2,770.9	13,841.4	4,377.9 ^b
GDP per head (US\$)	40,225	41,534	45,445 ^a	45,818 ^a	34,345
GDP per head (US\$ at PPP)	33,522	33,275	35,048 ^a	45,818 ^a	33,611
Consumer price inflation (av; %)	2.3 ^b	1.5 ^b	2.3	2.9	0.1 ^b
Current-account balance (US\$ bn)	254.5	-30.0	-113.1	-738.6	212.1
Current-account balance (% of GDP)	7.7	-1.2	-4.1	-5.3	4.8
Exports of goods fob (US\$ bn)	1,354.12	548.0	441.4	1,149.2	676.9
Imports of goods fob (US\$ bn)	-1,075.43	-600.1	-616.8	-1,964.6	-571.9

^a Economist Intelligence Unit estimates. ^b Actual.

Source: Economist Intelligence Unit, CountryData.

Regional trends

Following reunification, most industry in the five former East German states had to be closed down. The Treuhandanstalt (THA, the privatisation and restructuring agency), founded in March 1990 and wound up at the end of 1994, played a central role in the reorganisation of the east German economy. The THA also was given control of most formerly East German state-owned enterprises, including most agricultural production organisations. It was charged with putting companies on a healthy footing, privatising them where possible,

or liquidating them where no other option was left, which turned out to be more frequent. The process was painful, involving millions of redundancies.

From a low base east German GDP grew rapidly in 1992-95, largely as a result of the boom in construction stimulated by large public reconstruction projects and the generous subsidies accorded to private housing investment. The abolition of some subsidies in 1995 and further cuts in subsidies in 2000 led to a collapse of construction investment, so that real construction investment for Germany as a whole fell in every year bar one between 1996 and 2005. This also meant that GDP growth in the eastern states was lower than in the west for most of the past few years.

Nominal gross value added in eastern manufacturing per hour (excluding construction) grew by 56% between 1999 and 2007, albeit from a low base, and in 2007 was equivalent to 74% of the level in west Germany. Manufacturing gross value added (excluding construction) now accounts for 23% of total gross value added in the east, compared with 27% in the west. There are positive trends, however. Significant new investment by western firms with state-of-the-art technology have come on-stream in recent years, particularly for semiconductors, optics and car assembly. However, the movement of the population from east to west, often involving those with the best employment prospects, is damaging eastern Germany's productive capacity. Unemployment rates in every east German state are higher than in western Germany.

The east German population still depends heavily on transfers from western Germany, and gross value added is substantially lower than gross income. Nominal GDP per head in the east, excluding Berlin, was 67.2% of the level in western Germany in 2007. However, this results partly from the higher unemployment as nominal GDP per head of the working population in eastern Germany amounts to 76% of the level in western Germany. Furthermore the gap narrows further in purchasing power terms, because prices in eastern Germany, particularly housing costs, are still lower than in the west. According to the Halle Institute for Economic Research, the cost of a typical basket of goods and services in eastern Germany was only 92.9% of the cost of the same basket in western Germany in 2002.

There are large regional differences even among the states of western Germany. The southern states of Bavaria and Baden-Württemberg are the most successful in attracting high-tech industry and in keeping down unemployment. The concentration of declining sectors such as coal and steel in Nordrhein-Westfalen and shipyards in northern Germany has caused job losses, but the regions are by no means short of other industries. There are also weaknesses in the two small border states of Saarland (coal and steel) and Schleswig-Holstein (agriculture and shipbuilding) and in the city state of Bremen (shipbuilding and steel). Unemployment rates in western Germany in 2007 ranged from 4.9% in Baden-Württemberg to 12.7% in Bremen.

The external sector

The current account

West Germany's current account was in surplus for most of the period from the mid-1950s until reunification in 1990, but in 1991 the current account swung

into deficit. There were deficits in all subsequent years to 2000, but the situation has since changed, and the country has returned to its tradition of large current-account surpluses. The surpluses have been rising steadily to a record high (since reunification) of 7.7% of GDP in 2007. Germany's status as a rich industrialised country with fairly low growth potential and the need to save in the face of an ageing demographic structure suggests that the country will continue to run surpluses, but there is also a cyclical element to the current-account surplus, so that a moderate decline would appear likely.

Main composition of trade

(US\$ bn; fob-cif)

	2003	2004	2005	2006	2007
Exports fob					
Machinery & transport equipment	402.0	483.0	507.7	564.8	674.2
Chemicals & related products, n.e.s.	97.4	122.6	133.6	155.2	191.1
Food, drinks & tobacco	33.5	39.0	44.1	49.0	59.4
Mineral fuels, lubricants & related materials	12.3	18.0	21.9	29.5	32.5
Total exports incl others	754.2	903.5	975.5	1,121.7	1,332.4
Imports cif					
Machinery & transport equipment	242.4	287.0	304.0	347.4	395.0
Chemicals & related products, n.e.s.	67.5	84.1	96.3	113.0	142.4
Mineral fuels, lubricants & related materials	54.6	66.5	92.8	115.4	118.5
Food, drinks & tobacco	44.4	49.4	53.5	59.2	70.4
Total imports incl others	606.0	711.8	779.0	921.7	1,059.2

Source: Economist Intelligence Unit, *CountryData*.

The services balance has recorded persistent deficits, mainly because Germans travel a lot, but the deficit has been on a downward trend since 2001. Among the other main service activities, transport and financial services have netted consistent if modest surpluses in recent years, but patents and licences have been in deficit. For most of the 1990s and up to 2004 Germany ran a deficit on the income balance, but there has been a return to surplus since 2004. There have been substantial fluctuations in the balance on capital income, while there is typically a modest deficit on income from employment.

There is a significant deficit on current transfers, amounting to €30.7bn in 2007. This stems from several sources. First, foreign workers in Germany have been consistently remitting about €3bn per year abroad, with only a slight downward trend. Second, there has been a growing deficit on other private current transfers. Third, net bilateral development aid and other public bilateral transfers amounted to €2.1bn in 2006. Fourth, and most importantly, Germany's gross contribution to the EU budget was €13.4bn in 2006, in terms of balance-of-payments data.

Since 2003 Germany has held the position of the world's largest exporter of goods. Germany's exporters have been in a strong position to benefit from the strengthening of central and east European economies and the strong demand growth from Asia. The upswing among emerging-market economies in recent

years has benefited Germany in particular, thanks to its strong specialisation in machinery and equipment, which is in high demand in these countries, as they seek to enhance their production capacity.

Total exports grew in value in 2007 by 8.5%, to €969bn, while imports grew only at only 5%, to €770.4bn, pushing the trade balanced to a new record level of €198.6bn. The largest trade surpluses were recorded with France (€28.9bn), the US (€27.7bn), the UK (€27.6bn) and Spain (€27bn), while large deficits were recorded in trade with China (€24.7bn), Ireland (€11.5n) and Japan (€11bn). The largest single export category is road vehicles and parts (18.7% of the total), followed by machinery (14.3%) and chemical products (13.2%). Germany is much less affected by direct competition from low-wage countries than other European countries, such as Italy and Spain, because it focuses primarily on high-value-added goods.

Main trading partners

(% of total)

	2003	2004	2005	2006	2007
Exports fob to:					
France	10.4	10.4	10.2	9.5	9.7
US	9.1	8.9	8.8	8.5	7.5
UK	8.2	8.4	7.9	7.2	7.3
Italy	7.3	7.2	6.9	6.6	6.7
Imports cif from:					
Netherlands	8.2	8.4	8.5	11.7	12.0
France	9.0	9.1	8.7	8.5	8.6
Belgium	4.8	5.0	5.0	7.2	7.8
China	4.6	5.7	6.3	5.9	6.2

Source: Economist Intelligence Unit, *CountryData*.

The capital account

Flows on the financial account (reported here in terms of national data compiled by the Bundesbank (the German central bank), which may differ slightly from IMF figures, but are published in greater detail) are substantial in both directions. German portfolio investment in foreign securities amounted to €166bn in 2006, while inward portfolio amounted to €161bn. Net outflows of foreign direct investment (FDI) have far exceeded net inflows for two decades, except in 2000, 2002 and 2003. The inflows in 2000 were driven by the takeover of Mannesmann by Vodafone-Airtouch (UK). In 2002, 2003 and 2004 an increasing number of German companies seems to have repatriated investments made abroad, possibly related to efforts to refocus and strengthen their balance sheets. In 2004 this pattern was more than offset by substantial disinvestment by foreign companies reducing their exposure to Germany. This may have been caused by changes in corporate tax codes, which made holding funds in Germany less attractive. Both inward and outward FDI increased in 2005 and 2006, although outward investment, at €63.3bn in 2006, was nearly twice as high as inward FDI. The gap widened further in 2007, when outward FDI reached record highs and inward direct investment fell slightly.

German FDI has mostly gone to the EU25 countries, where Germany had an estimated FDI stock of €434bn at the end of 2006, and to the US, where the German FDI stock was €164.3bn in that year. The overall stock of FDI was €728.1bn. Only around one-fifth of the stock of German outward FDI in 2006,

some €131.2bn, was in manufacturing. Of the €588.5bn stock of FDI held by foreign companies in Germany, €427.2bn came from other EU25 countries. The manufacturing industry accounted for €66bn of this.

For an analysis of the latest external-sector data, see the Economist Intelligence Unit's most recent **Germany Country Report**.

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- Deutsches Institut für Wirtschaftsforschung (Berlin): www.diw.de
- Halle Institute for Economic Research (IWH, www.iwh.uni-halle.de)
- Ifo Institut für Wirtschaftsforschung and Centre for Economic Research (CES): www.cesifo.de
- Kiel Institute for World Economics (www.uni-kiel.de/IfW/)
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Council of Wise Men (advising the government on economic affairs):
www.sachverstaendigenrat.org

Appendix

Index methodology

Measuring democracy

There is no consensus on how to measure democracy. A key difference in measures is between "thin" or minimalist, and "thick" or wider concepts of democracy. The Economist Intelligence Unit's democracy index is a thick measure. In addition to measuring political freedoms and civil liberties (the essential components of any definition), other features also need to be assessed in order to determine how substantive democracy is. Our index is based on five categories: electoral process and pluralism; civil liberties; the functioning of government; political participation; and political culture. The index provides a snapshot of the current state of democracy worldwide for 167 independent states and two territories (this covers almost the entire population of the world and the vast majority of the world's independent states).

The overall index of democracy, on a 0 to 10 scale, is based on the ratings for 60 indicators grouped in the five categories. The overall index is the simple average of the five category indexes.

We use a three-point scoring system for the 60 indicators. A dichotomous 1-0 scoring system (1 for a yes and 0 for a no answer) is used for most indicators. For some indicators, a 0.5 score is possible, where a simple yes (1) or no (0) is problematic. The category indexes are based on the sum of the indicator scores in the category, converted to a 0 to 10 scale. Adjustments to the category scores are made if countries do not score a 1 in the following critical areas for democracy:

- whether national elections are free and fair;
- the security of voters;
- the influence of foreign powers on government; and
- the capability of the civil service to implement policies.

The index values are used to place countries within one of four types of regimes:

1. Full democracies—scores of 8 to 10.
2. Flawed democracies—scores of 6 to 7.9.
3. Hybrid regimes—scores of 4 to 5.9.
4. Authoritarian regimes—scores below 4.

A differentiating aspect of the index is that in addition to experts' assessments we use, where available, public opinion surveys. Indicators based on the surveys predominate heavily in the political participation and political culture categories, and a few are used in the civil liberties and functioning of government categories. To view the full methodology and the complete questionnaire, visit eiu.com.

Editors: Dan O'Brien (editor); Charles Jenkins (consulting editor)
Editorial closing date: September 26th 2008
All queries: Tel: (44.20) 7576 8000 E-mail: london@eiu.com