GERMAN COUNCIL
of Economic Experts

MASTERING THE FINANCIAL CRISIS – STRENGTHENING FORCES FOR GROWTH

Annual Report 2008/09

Summary

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First Chapter

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Preface

The German Council of Economic Experts (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung) hereby presents the English translation of the complete first chapter of its Annual Report 2008/09. The first chapter gives a brief review of the latest developments, prospects and policy issues of the German economy discussed in the report.

The complete report is divided into six chapters.

I. Mastering the financial crisis, strengthening forces for growth
II. The economic situation and development in the world and in Germany
III. Financial system in intensive care
IV. Fiscal policy: need for policy action in the short and long term
V. Labour market: ongoing revival – chances unevenly spread
VI. Social security: track record of half-hearted efforts

The data used in the report of the Council were the latest available in end-October 2008.

The German Council of Economic Experts consists of five independent economists. They are appointed by the President of the Federal Republic of Germany, after nomination by the Government. Appointments are for five years, with the possibility of renewal (see 1963 Law on the Appointment of the Council in the appendix). For further information about the Council contact the address below or the Internet homepage.

At the time when the 2008 report was submitted the members of the Council were

Peter Bofinger **Wolfgang Franz** **Bert Rürup** (Chairman)

Beatrice Weder di Mauro **Wolfgang Wiegard**

Address: Sachverständigenrat zur Begutachtung der
gesamtwirtschaftlichen Entwicklung
Statistisches Bundesamt
D-65180 Wiesbaden
Germany

Phone: +49 / 611/ 75 2390 / 3640 / 4694 - Office
+49 / 611/ 75 2762 - Secretary general: Dr. Ulrich Klüh
Fax: +49 / 611/ 75 2538
E-mail: srw@destatis.de
Internet: http://www.sachverstaendigenrat.org

CHAPTER ONE

Mastering the financial crisis – Strengthening forces for growth

I. The German economy in the wake of the financial crisis

1. Germany is now feeling the full impact of the shockwaves emanating from the global financial crisis that started in the summer of 2007. After a surprisingly good start in the first quarter of 2008, the economic situation deteriorated so radically that Germany slid to the brink of a recession. Although gross domestic product still managed to grow by 1.7 per cent in 2008, the country's economic output will stagnate in 2009.

Systemic banking crisis successfully halted

2. The turbulence which erupted in the global financial system for the first time in July 2007 reached a new dimension in September 2008. The unexpected insolvency of Lehman Brothers shook the market players' confidence in the stability of banks and insurance companies so massively that credit relationships between financial institutions came to a virtual standstill. Without government intervention the systemic crisis would have led to a collapse of the entire financial system. Not only interbank lending but also lending to enterprises and households would have dried up. This would have conjured up the danger of a run on the banks as savers would have sought to withdraw their deposits on a mass scale. As loans have a significantly longer maturity than deposits, banks are by nature never in a position to pay out all their depositors' holdings in cash simultaneously. Enterprises and households would then no longer to be able to have full and free access to their credit balances and savings. Public confidence in the banking system would have been destroyed and the financing of real economic activities would have collapsed.

3. Hence there was no alternative to the coordinated, comprehensive and in part extremely unorthodox measures that were taken by central banks and governments. By granting extensive liquidity assistance and cutting interest rates, the **central banks** ensured that the banks were able to meet their payment commitments in full even under the extreme conditions that prevailed in the past few weeks. The task of the **governments** has been to find solutions for the acute solvency problems facing a number of banks, especially by injecting extra capital. Thanks to the government rescue shields and the comprehensive willingness of the central banks to act as lenders of last resort, the most important economies have meanwhile managed to put their financial systems back on a stable footing. This has banished the danger of a collapse of the financial system. This does not preclude the possibility that individual banks may still experience deep distress.

Substantial real economic consequences, but no extreme developments expected

4. With the financial system being buffeted by such turbulent shocks, the real economy has inevitably been sucked into the maelstrom, especially as the world economy had already entered a cooler cyclical phase following a very long and robust period of expansion. In view of the exceptionally large fluctuations that have been witnessed this year in exchange rates, share price indices and commodity prices, it is extremely difficult at the present time to forecast the likely evolution of the macroeconomic setting going forward. Extreme scenarios can be ruled out, however.

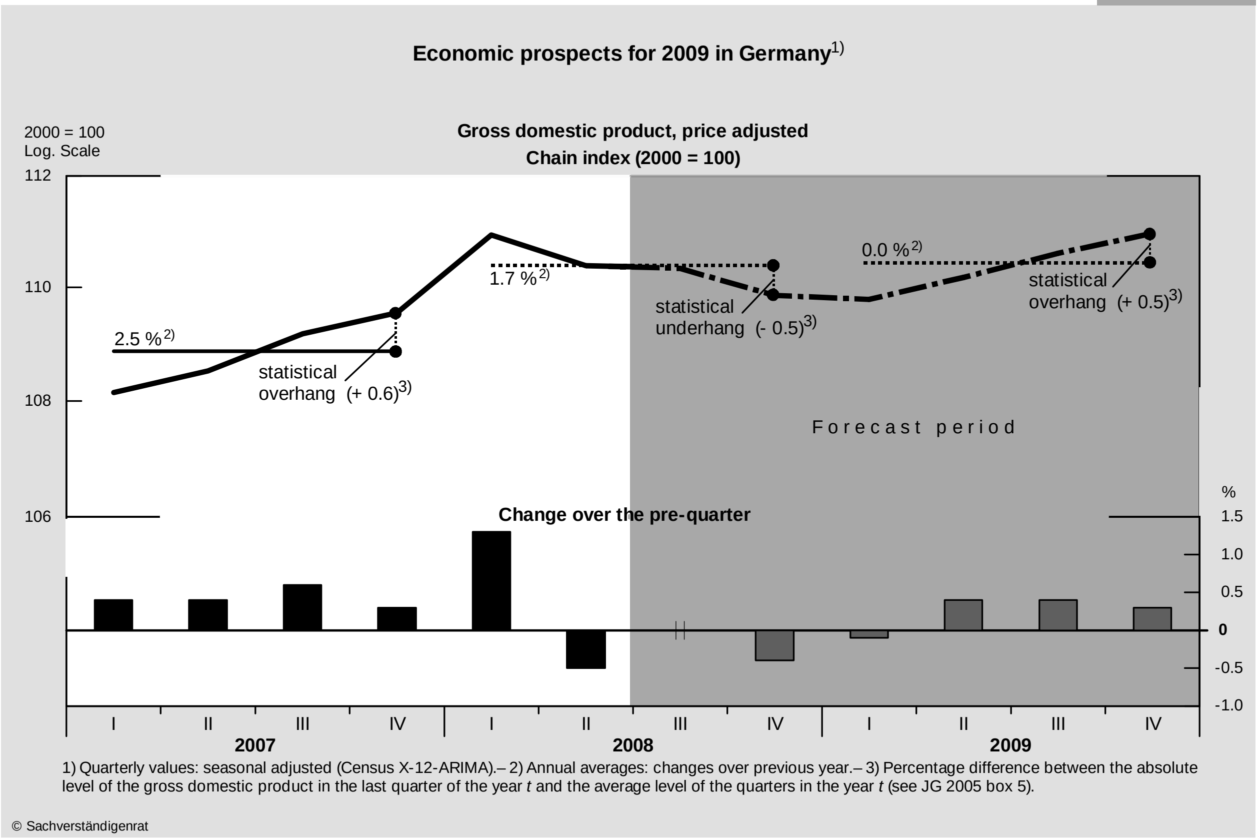
There will be no re-occurrence of a **world economic crisis** such as the one experienced in the 1930s. In contrast to the situation at that time, central banks around the world were able to react very quickly and incisively with a coordinated interest rate reduction. Unlike then, monetary authorities are no longer subject to the straitjacket of a currency regime pegged to a gold standard. Governments, too, have learned from the mistakes committed in the past. They know that it would be both wrong and dangerous to pursue a restrictive fiscal policy stance in a sharp economic downturn.

Another highly unlikely scenario is a steep rise in **inflation**, even though this has been the subject of some public speculation in connection with central banks' support measures. While it is true that a substantial amount of additional liquidity has been provided, central banks merely replicated cash cycle functions which, in normal circumstances, are provided by financial institutions themselves. In fact, the stock of money which households and enterprises keep lodged at the banks, and which is thought to be linked to the level of inflation in the long term, rose less rapidly in the last few months than during the period preceding the current financial crisis.

5. Even if extreme scenarios can be ruled out, it is improbable that the world economy will noticeably pick up speed again soon. Many countries are currently confronted with a profound **crisis on the real estate market**. Germany's corresponding experience in the 1990s indicates that such excess capacity on property markets can only be reduced gradually. Other obstacles to a rapid recovery are presented by the **problems in the banking sector**. The excessive risk appetite which the sector demonstrated over the past few years is likely to give way for a much more cautious approach – not least owing to the assumption of risks by government. In addition, many institutions are short of capital, which makes it impossible for them to pursue a more expansionary business policy. Among the principal retarding factors are the large **wealth losses sustained by US households**. In recent years, their pronounced propensity to incur debt procided the basis for forceful demand stimuli for the global economy. This formed a necessary counterweight to the high level of financial asset formation in countries such as China, Japan, Germany, Russia and a number of oil-producing countries. One of the consequences of the much discussed **global imbalances** (Annual Report 2006 sections 141 ff.) was that, ultimately, they enabled the world economy to record dynamic growth amid such diverse national saving patterns. In the wake of falling house prices and plummeting share prices, households in the United States – whose saving ratio has been close to zero for years – are now faced with the need to save a much bigger portion of their current income. Given that private consumption accounts for a share of around 70 per cent of US gross domestic product, it is therefore exceedingly improbable that the United States will repeat the feat it performed during the downswing of 2001/2002 and again power the global economy forward. Adjustment problems similar to those being experienced in the United States are also confronting numerous **countries in southern and eastern Europe**.

6. Owing to the worsening external conditions, the real economy in Germany is likely to go through difficult times, at least in the short term. After a **growth rate of gross domestic product** of 1.7 per cent in 2008, the German Council of Economic Experts (*Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung*) anticipates a **stagnation** of aggregate economic output for the year 2009. These annual averages mask a quarter-on-quarter contraction which began as early as in the second quarter of 2008 and will continue until the first quarter of 2009 (Chart 1). Owing to the very sharp drop in oil prices and the effects from further ECB interest rate cuts, a modest recovery is to be expected in the course of 2009. Nevertheless, the rebound will remain distinctly below the medium-term potential growth rates.

Chart 1



Apportioning the blame for the financial crisis

7. The global financial crisis has reanimated widespread debate about the functional viability of the free-market economy. In condemning "cowboy capitalism" and a system in which profits are supposedly privatised while losses are nationalised, numerous critics have levelled accusations against bank managers and called into question the very principles of market-based economies. In its place the critics are calling for a much more active or even dominant role of the state, and at the very least much heavier regulation and the protection of domestic enterprises ("national champions").

This criticism overlooks, for one thing, the fact that regulatory interventions in the financial markets are already commonplace. In fact, financial markets are subject to a far higher level of regulation than many product markets. There are good grounds for such government intervention. As a general principle government intervention is warranted whenever markets fail to function properly and the government can resolve the associated problems better than the private sector – in other words, the danger of market failure must always be weighed up against the danger of government failure. Market failure may be caused by several different factors. In the case of financial markets one of the principal causes of dysfunction are problems concerning the unequal distribution of information between lenders and borrowers (asymmetric information) as is the case, for instance, with securitised and structured financial products. While information problems can also exist on some product markets – the second-hand car market is a typical example – the consequences of market failure are usually restricted to the market in question; hence it is sufficient if the role of government intervention is limited to laying down a few statutory ground rules. In contrast, financial markets are characterized by systemic risks: The collapse of just one financial institution might trigger the implosion of the entire financial system and would also drag down the real economy. This is the reason why financial markets must be subject to a higher level of regulation.

However, the criticism of allegedly unbridled financial markets misses the point. The key issue is not the undisputed need for regulation, but rather the need for a more intelligent system of regulation which would lessen systemic risk by ensuring more transparency and better risk buffers. Moreover, it is not a question of eliminating each and every individual risk, because earning bigger returns inevitably entails incurring higher risks. The same holds for other economic activities: bigger and better opportunities of achieving success entail a higher risk of failure. And it is certainly not a question, in the context of the financial crisis, of calling the free-market economy as such into question. The German Council of Economic Experts explicitly cautions against the danger of overregulation and a resurgence of protectionist tendencies.

8. When it comes to apportioning blame, the finger has been pointed variously at the monetary policy makers, the government overseers of the financial system, the rating agencies and other decision-makers on the financial markets. In the United States an expansionary monetary policy stance fostered the formation of a real estate market bubble, while, with a view to boosting the level of home ownership, economic policymakers egged on the banking sector to grant mortgages even to borrowers with a subprime credit standing. For their part, the prudential supervisory authorities imprudently acceded to demands for deregulation, for example by relaxing the capital adequacy rules for US investment banks. Most countries widened the banks' discretionary latitude in valuing and hedging risks; this resulted in inadequate risk buffers, which in turn reinforced the procyclicality of the system. The rating agencies were equally at fault because they issued top-notch ratings despite having insufficient experience of financial innovations. The fragmented international, but in some instances also national, banking supervisory authorities were also found wanting. Nor are bank managers free from their share of guilt. They paid insufficient regard to one of the golden rules of the financial markets, namely that very high returns on investment can only be achieved by incurring very high risks, and they also relied too much on the valuations of the rating agencies. There is no denying either that some remuneration systems supported, or perhaps even encouraged, short-term thinking and acting on the part of bank managers. To that extent banks' supervisory boards likewise bear some responsibility.

II. Stabilising the financial markets

9. In view of the magnitude of the current crisis, economic policymakers find themselves fighting on several different fronts. Following the successful efforts to ward off a systemic crisis on the financial markets, the next step worldwide must be to **restructure the financial institutions** so that they can quickly regain their stability and efficiency and thus operate without government assistance. The lessons learned from the banking crises over the past decades underscore the need to concentrate government support on institutions which have a viable business model. It would be wrong to try to keep as many banks as possible afloat at any price. A highly successful strategy in this respect was pursued during the Swedish banking crisis in the 1990s. By contrast, the largely passive role which the government of Japan played in the crisis which erupted there in the same decade meant that it took a very long time until the country's banks were able to regain strength and international competitiveness.

10. In the present crisis economic policymakers in most countries initially responded to the escalating crisis by coming up with case-by-case solutions for individual banks. In October of this year they then changed tack by taking a holistic approach. On 13 October 2008 the German Federal Government (*Bundesregierung*) adopted a rescue programme for the German financial system. The **Financial Market Stabilisation Act** (*Finanzmarktstabilisierungsgesetz*) was passed just a few days later by both the lower house (*Deutscher Bundestag*) and the upper house of parliament (*Deutscher Bundesrat*) and became law on 18 October 2008. The cornerstone of this legislation is the establishment of a Financial Market Stabilisation Fund (*Finanzmarktstabilisierungsfonds*). Endowed with a range of financial support measures totalling up to 480 billion euro, the Fund's mandate is to safeguard the stability of banks, insurance companies, pension funds and other financial institutions that are domiciled in Germany. The Fund is equipped with three different instruments for combating the crisis. First, it is **authorised to provide guarantees** worth, in the aggregate, up to 400 billion euro, to help reanimate mutual lending between banks. Second, the Fund can take an equity stake in financial institutions that are seeking support by injecting capital with a view to offsetting the crisis-related erosion of their equity base by way of **recapitalisation**. Third, banks and other financial institutions can request the Fund to assume or underwrite **risky balance sheet exposures**, such as securitised claims in connection with US mortgage loans which were incurred prior to 13 October 2008.

11. The adopted measures are not aimed at protecting the managers or owners of individual financial institutions. Instead, the objective is to ensure that the **financial system** is able to maintain its central function as an intermediary between savers and investors and thus contribute to a stable macroeconomic development. It is solely banks' key relevance for the real economy that justifies the massive mobilisation of taxpayers' money and the associated toleration of the negative incentive effects of such rescue programmes.

12. At the moment it is too early to attempt to comprehensively evaluate the German rescue package. One undeniably positive feature of the programme is that the earlier case-by-case solutions have been superseded by a holistic approach to resolving the problem. This will make an important contribution to stabilising trust and confidence on the part of both the financial market players and the general public.

13. The success of the rescue package hinges on the ability of the newly established **Special Fund for the Stabilisation of the Financial Market** (*Sonderfonds Finanzmarktstabilisierung*) to elaborate a convincing and cogent concept for a lastingly viable financial system. Otherwise there is a danger that the Fund might adopt a passive role with regard to necessary restructuring processes and readily acquire large capital stakes in enterprises which do not have a convincing business model. In the longer run this could have a paralysing effect both on the dynamism of the financial system and on the dynamics of the real economy. Given the outstanding importance which an efficient financial system has for economic growth, attention should be clearly focused now on preventing such a misdirected development. A second potential danger is that the Special Fund for the Stabilisation of the Financial Market might intervene in financial enterprises' daily businesses over a prolonged period. The past experience of government-run banks in Germany suggests that this would be a grim prospect.

The primary goal, therefore, must be to use the means available to government in order to engineer a restructuring of the financial system in the months ahead with a view to ensuring that an efficient and competitive banking landscape is rapidly restored in Germany. A prerequisite for this is that the state withdraws again once the stabilisation and restructuring process has been successfully completed and refocuses on its core tasks.

14. In view of their historic dimensions, the rescue programmes will create substantial **incentive problems** for the future. With their fundamental willingness to protect bank creditors against asset losses, governments are encouraging a mindset which may massively boost the risk propensity of lenders. It is therefore to be welcomed that far-reaching reforms aimed at bringing about a more stable international financial architecture are currently on the agenda. A key requirement in this respect is that the states really are prepared to surrender national competencies in the field of supervising financial markets. In the view of the German Council of Economic Experts the debate needs to focus on two points in particular.

With regard to the discussion about achieving a stronger **global orientation of financial market oversight**, the first question to be answered is what tasks are to be performed at the supranational level in future. The main challenge consists in setting up an international early warning system that must have access not only to macroeconomic information but also to microprudential data on individual large financial institutions. Additional functions, such as evaluating national prudential supervisory systems, monitoring the biggest internationally active financial institutions or carrying out global crisis management, could be bolted onto this platform. As a global institution, the International Monetary Fund (IMF) is best suited to tackling these tasks. Irrespective of what can be achieved at the international level, it is also imperative to create more efficient structures, especially for the European Union.

In addition, the prudential supervisory framework must be altered with the aim of ensuring that the system's **risk buffers** are perceptibly strengthened and that they unleash smaller procyclical effects. This requires complementing the current capital requirements of Basel II, which are geared to risk-weighted assets, with a robust rule (**leverage ratio**) which lays down a fixed relationship between a bank's unweighted assets and its level of capital. Such a stipulation would also be suitable for dampening phases of overheating by reducing leverage. Another measure worth considering would be to supplement the consolidated financial statements of financial institutions based on the **fair-value** approach with a second accounting standard in which profits would only be shown when they are actually realised.

III. The German economy in a downturn

15. Germany was affected by the global downswing at a comparatively late stage, which is chiefly attributable to the fact that the **direct real economic impact** of the financial crisis has remained within fairly limited bounds up to now. The German real estate market has developed rather sluggishly in the past few years, with the result that little setback potential is to be expected from that quarter. For their part, German enterprises, on account of their buoyant profitability, were largely able to finance their investment projects from their internally generated funds, and at least the latest available opinion surveys for Germany indicate no serious deterioration of banks' credit standards. The fact that firms' business expectations are nonetheless less optimistic than at any time since the reunification of Germany highlights the strong **indirect consequences** of the worldwide turbulence on the German economy. As Germany's export performance during the current decade was extremely buoyant and domestic demand more or less stagnated at the same time, the export ratio rose to 48 per cent and is thus higher than in other large economies. Since major trading partners of Germany such as the United States, the United Kingdom, Spain and the group of east European countries have been hit particularly hard by the present financial and real estate crisis, this has had a powerful knock-on effect on the German economy through the **foreign trade channel**.

16. The **growth rate of gross domestic product** in Germany in 2008 amounted to 1.7 per cent. A surprisingly strong first-quarter performance was followed by a delayed but all the more abrupt slowdown, which was initially driven by external factors but simultaneously contained cyclical components (Table 1, page 8).

The cyclical slowdown, along with the turbulence on the international financial markets, left no noticeable negative impact on the **labour market** up to the end of 2008. The number of employed persons topped the 40 million mark, while in October registered unemployment fell below the level of 3 million persons for the first time in 16 years. The unemployment ratio declined on an annual average to a value of 7.8 per cent.

The **general government budgets** closed the current year with a small deficit and thus reinforced the fiscal consolidation advances achieved over the preceding years. Whereas the central government recorded another deficit for the fiscal year 2008, state and local governments posted budget surpluses. The available figures do not, however, contain the likely but not quantifiable burdens that will ensue from the measures taken under the Financial Market Stabilisation Act.

17. The downswing which began this year will initially continue in **the year 2009**. Only during the course of the year will the macroeconomic momentum pick up a little; the German economy will nevertheless grow less strongly than its potential, so that the output gap will widen. In 2009 the criterion of a recession developed by the German Council of Economic Experts will be met.

Table 1

Key economic data for Germany

	Unit	2005	2006	2007	2008[1)]	2009[1)]
Gross domestic product	%[2)]	*0.8*	*3.0*	*2.5*	*1.7*	*0.0*
Private households[4)]	%[2)]	*0.2*	*1.0*	*– 0.4*	*– 0.3*	*0.4*
General government	%[2)]	*0.4*	*0.6*	*2.2*	*2.0*	*2.2*
Investment in machinery & equipment	%[2)]	*6.0*	*11.1*	*6.9*	*5.1*	*– 6.3*
Construction investment	%[2)]	*– 3.0*	*5.0*	*1.8*	*3.3*	*– 0.5*
Other investment	%[2)]	*4.9*	*8.0*	*8.0*	*7.9*	*2.6*
Total domestic demand	%[2)]	*0.0*	*2.1*	*1.1*	*1.1*	*– 0.1*
Exports of goods and services	%[2)]	*7.7*	*12.7*	*7.5*	*4.2*	*0.4*
Imports of goods and services	%[2)]	*6.5*	*11.9*	*5.0*	*3.4*	*0.5*
Employment (domestic)	million	38.85	39.10	39.77	40.30	40.22
Registered unemployed	million	4.86	4.49	3.78	3.27	3.30
Employees[5)]	million	26.24	26.37	26.94	27.48	27.43
Unemployment rate[6)]	%	*11.7*	*10.8*	*9.0*	*7.8*	*7.9*
Consumer prices[7)]	%[3)]	*1.5*	*1.6*	*2.3*	*2.8*	*2.1*
General government balance[8)]	%	*– 3.3*	*– 1.5*	*– 0.2*	*– 0.1*	*– 0.2*

1) 2008: own estimate, 2009: forecast.– 2) Price-adjusted; changes over previous year.– 3) Change over previous year.– 4) Including private non-profit institutions.– 5) Employees subject to social insurance contributions.– 6) Share of registered unemployed in total civilian labour force (dependent civilian employed persons, self-employed, family workers). Source: years 2005 to 2007 Federal Labour Office (Bundesagentur für Arbeit).– 7) Consumer price index (2005 = 100).– 8) Net lending of the central, state and local governments and the social security funds, as % of nominal gross domestic product. In the result of the years 2008 and 2009 the potential effects of the Financial Market Stabilisation Act (Finanzmarktstabilisierungsgesetz) are not considered.

According the German Council of Economic Experts' criterion, a **recession** exists when a decline in the relative output gap amounting to at least two-thirds of the respective potential growth rate coincides with a negative current output gap. With a relative output gap of around 0.9 per cent in 2008 and an output gap of around -0.5 per cent expected for 2009, this adds up to a decline in the relative output gap of around 1.5 percentage points. The level of this rate of decline is well above the value of two-thirds of the potential growth rate, which currently amounts to 1.6 per cent.

As a consequence of the cyclical slowdown, the improvement of the labour market situation, which has endured for three years now, will come to an end. The **number of employed persons** will fall on an annual average by 81,000 persons. The number of **registered unemployed** will rise from an average of 3.27 million persons in 2008 to 3.30 million next year.

The **general government fiscal balance** will **deteriorate** as a result of the slowing general economic momentum. In view of the marked worsening of the cyclical conjuncture, it may seem surprising that the budget deficit will increase only marginally in 2009. For one thing, this is due to the fact that the appropriations for 2008 contain just under 5 billion euro to cover the financial burdens ensuing from the financial crisis, whereas the forecast value for 2009 cannot yet contain any corresponding burden. Moreover, it should be remembered that, with respect to the development of expenditure, the cyclical downturn will have an impact on the labour market only with a certain time-lag. With regard to the revenue side, the higher negotiated pay rates that were concluded in the recent past will have a stabilising effect on tax receipts.

18. The German Council of Economic Experts considers the forecast presented here for the year 2009 as the most likely scenario of overall economic development in the coming year. It should be borne in mind in this context that key macroeconomic variables such as exchange rates, commodity prices, share prices and other asset prices displayed an extraordinarily high volatility in the past few months and in some cases lurched quite erratically. This reflects the interplay and overlay of serious macroeconomic shocks. Consequently, the current forecast is subject to a particularly large margin of uncertainty, with the downside risks predominating.

IV. Economic policy: what is to be done

19. The sharpness and deepness of the general economic disruptions confront economic policymakers with major challenges. Clear stimuli are needed to strengthen the internal growth forces and domestic demand. Measures have been taken in Germany, as in many countries, to strengthen the real economy and to safeguard jobs. A large number of the options being discussed in this context, however, are an expression of political activism, motivated in part by industrial policy considerations, which could at least lead to misguided decisions in the field of growth policy.

1. A growth-oriented policy aligned with short-term cyclical needs

20. In the United States and in Japan the central banks have virtually exhausted their stock of interest rate policy options. The **European Central Bank** should make use of the leeway available in the coming year to lower its key interest rates. As the current disruption is overwhelmingly a negative demand shock which is affecting all the counties of the euro area, interest rate policy is the first-choice instrument as it can be deployed quickly and will also have a powerful strengthening impact on the earnings situation of the banking system.

21. In Germany the main onus of action is on the **fiscal policymakers**. In view of the fact that appreciable external impulses cannot be anticipated for the foreseeable future, the further course of economic momentum hinges above all on domestic demand. Owing to the oil price-related fall in the inflation rate and the lagged reaction of unemployment to the economic slowdown, there are justified grounds for hoping that private consumption will increase again in 2009 for the first time in several years. A marginally positive contribution to growth can also be expected from government consumption.

22. Given the exceptionally large uncertainties concerning the further path of economic development, the German Council of Economic Experts is not in favour of short-term stimulus programmes but rather advocates that fiscal policymakers should initiate measures aimed at securing a **growth-oriented policy aligned with short-term cyclical needs**. In the wake of the fiscal consolidation measures of the last few years, **government investment** was pruned back so sharply that since 2003 it has failed even to match the consumption of fixed capital. This means that the public sector is living off its capital. As the German Council of Economic Experts pointed out in its expertise on government indebtedness (*Expertise zur Staatsverschuldung*), it would be quite legitimate for net government investment, in compliance with a rule pegging the borrowing ceiling to the level of new investment (golden rule of fiscal policy), to be financed by public borrowing. Hence it is defensible for net government investment to be expanded next year and financed by incurring a higher deficit. Appropriate objectives for investment are, in particular, public projects that have already been approved in the area of the transport infrastructure which to date, however, have been put on the back-burner on account, amongst other things, of a lack of potential funding.

Another suitable option within the framework of a growth-oriented policy aligned with short-term cyclical needs is higher spending on education, especially for the promotion of young children. Expenditure in this field can be financed by new borrowing for as long as the output gap is negative. As soon as this ceases to be the case, higher taxes or spending cuts in other areas are required in order to return as soon as possible to the course of consolidation, which is the proper path in terms of growth policy.

Lastly, policymakers should consider making corrections to the reform of business taxation with a view to strengthening the demand for corporate investment. The prime candidates for consideration in this respect are a raising of the interest deduction ceiling (*Zinsschranke*) and a general return to the declining-balance depreciation facility for moveable tangible fixed assets.

The measures to be adopted should have a certain minimum volume large enough to generate sizeable expansionary effects on demand. The corresponding magnitude should lie initially between approximately 0.5 per cent and 1 per cent of gross domestic product.

2. Improving the conditions for growth and employment

23. It is important to trigger the aforementioned growth impulses quickly so as to both overcome the current economic malaise faster and to increase the macroeconomic potential output. It would be wrong, however, if the policymakers were to misuse these efforts needed to counter the expected economic slowdown as an excuse to relax the drive to press ahead with the reforms initiated in the past few years

- in the field of fiscal policy
- in the regulatory institutional framework of the labour market or
- in the area of the social security systems

with a view to achieving higher trend-growth.

Fiscal policy: dismantling the distortions

24. If there were two projects for which a grand coalition between Germany's two largest political parties, such as the present one between the Christian Democratic Union (*Christlich Demokratische Union – CDU*) and the Social Democratic Party (*Sozialdemokratische Partei Deutschlands – SPD*), would appear ideally suitable to tackle, it would bee, first, the task of **restructuring the financial relationships** between central government (*Bund*) and state government (*Länder*) and, second, reaching agreement on a binding debt brake rule (*Schuldenschranke*) applicable equally to central and state government. The commendable attempt undertaken with the establishment of the second commission to reform Germany's federal structure, the Federal Reform Commission II (*Föderalismuskommission II*), to shift the coordinates of the relationships between the different tiers of government away from the present collaborative federalism towards a more competitive federalism must meanwhile be deemed to have failed. Moreover, from the current perspective there appears to be little prospect either that a **debt brake** which would lastingly safeguard the consolidation of the general government budgets – via a recasting of Article 115 of the Basic Law (*Grundgesetz*) and corresponding provisions in the constitutions of the state governments (*Landesverfassungen*) – will be introduced during the present legislative period. This would be all the more regrettable as a coherent concept has been developed by the Federal Ministry of Finance (*Bundesfinanzministerium*) which incorporates key elements of the German Council of Economic Experts' Expertise from 2007. In view of the financial risks associated with the efforts to combat the escalating turbulence on the financial markets, one can only wish that at least the Federal Government, i.e. central government, will find the strength next year to implement what is, seen in a longer-term perspective, the most important outstanding fiscal policy project for its sphere of political responsibility.

25. The **reform of inheritance tax law** called for this year, not least by a ruling of the Federal Constitutional Court (*Bundesverfassungsgericht*) of 7 November 2006, is in danger of turning into a fiasco. The draft legislation now on the table is fundamentally flawed as it serves primarily to satisfy the vested interests of individual social groups. Discountable carve-outs (*Verschonungsabschläge*) of 85 per cent for business assets, agricultural and forestry assets and for equity stakes in corporations (*Kapitalgesellschaften*) of which the bequeather (or donor) holds over 25 per cent of the nominal capital are unjustified from every angle. The unequal and inequitable treatment vis-à-vis rented property, with a carve-out of 10 per cent, is glaring. Nor will this achieve the aspired aim of maintaining jobs in Germany, since the carve-out clause continues to apply in the event that an enterprise is relocated to another EU country after the assets have been bequeathed and the criteria for a tax-exempting continuation of the business in that country are satisfied.

The German Council of Economic Experts considers inheritance tax a sensible tax. When it comes to achieving distributive objectives, inheritance tax is actually a premier taxation instrument. What is called for, therefore, is a reform of inheritance tax which affords equal treatment to all categories of assets – not only in terms of their valuation but also of the applicable tax rates – and which envisages a general tax deferral rule for illiquid asset types (especially business assets, agricultural and forestry assets and real estate property) as well as a substantial reduction in the tax rates in tax class I (*Steuerklasse I*) applying to the spouse, children and other direct descendants. Given a choice between the present draft legislation and the abolition of inheritance tax, scrapping this tax would, in fact, would have been the lesser evil.

26. Imposing a **final withholding tax** (*Abgeltungsteuer*) on private capital income is, in itself, a meaningful measure. But if such a tax is poorly coordinated with the business taxation regime, this can lead to growth losses owing to the impairment of national investment activity to which it gives rise. As the final withholding tax that will enter into force on 1 January 2009 will actually magnify the existing distortions with regard to entrepreneurial financing choices and will lead to a problematic discrimination of equity financing compared with debt financing, there are very real concerns that this tax will have disadvantageous allocation effects. For this reason there is an urgent need for policymakers to take action, particularly on growth policy grounds, with a view to **tightly dovetailing** final withholding tax and business taxes.

Labour market: lowering further the level of structural unemployment

27. The reforms carried out in the period from 2002 to 2004 went a long way along the path towards restructuring the **labour market**. These measures were, admittedly, not the sole claim to paternity of the pleasing evolution of the unemployment and employment figures during the last three years because, along with the dynamic macroeconomic development, the pursuit of a moderate wage policy on balance likewise contributed to the upswing on the labour market. The cyclical component of unemployment was virtually eliminated in 2008, and, thanks to the labour market reforms, the non-cyclical component of unemployment – in other words, the entrenched, structural level of unemployment – has likewise decreased appreciably for the first time in many years. This means that the first fruits of reform policy and wage policy have already begun to be harvested. The primary task now is to safeguard as far as possible the progress that has been achieved to date during the anticipated cyclical downturn and to bolster a subsequent rebound in employment. Concretely, this includes spreading the chances and risks on the labour market more evenly so as to reinforce the basis for averting a potential renewed entrenchment of unemployment. This is necessary because, in the past few years, a growing split has manifested itself on the labour market between the core workforce and peripheral workers. At present, the extra flexibility that has been added to the labour market and the associated adjustment burdens are being borne predominantly by atypical forms of employment, i.e. the favourable development of the labour market has not yet percolated through to all employee groups.

28. In order to further reduce structural unemployment, in particular, the German Council of Economic Experts is proposing a coherent package of measures that will have an impact in the longer term. The elements of this reform package will not handicap current jobholders during the forthcoming downturn on the labour market but rather are aimed at improving the prospects of jobless persons during future upturns.

The reform package comprises the following elements.

- The problem groups on the labour market can be helped by an effective **wage subsidy model** (*Kombilohnmodell*), i.e. a combination of wage substitutes and wages, integrated into the minimum basic allowance of unemployment benefit II (*Arbeitslosengeld II*). It would be counterproductive in this context to introduce a minimum wage, whether at a national level or on a sectoral basis.

- New job opportunities can be opened up for peripheral employee groups by making corrections in favour of standard employment relationships. Affording privileged treatment to atypical forms of employment, e.g. with respect to the payment of taxes and social contributions, should be terminated. **More flexible statutory employment protection legislation** would lower the present hurdles to setting on new staff. To this end the German Council of Economic Experts proposes that compulsory redundancies should be made generally permissible as long as a binding severance compensation rule has been agreed beforehand. This new rule would apply to newly concluded employment contracts, while existing jobs would continue to be covered by the old arrangements under a grandfathering clause. In order to spread the financial burdens associated with laying off workers more efficiently and to internalise them more within the enterprises, the legislature could consider, in addition, undertaking a **reform of the statutory unemployment insurance scheme** (*gesetzliche Arbeitslosenversicherung*) in the form of introducing a downward sliding scale of unemployment benefit and differentiated employer contributions to the scheme in a manner similar to the corresponding arrangements in the United States ("experience rating").

- All employee groups would benefit from a continuation of a **collective wage bargaining policy geared to boosting employment**. Such a policy stance helps to create new competitive jobs and can also stimulate private consumption through the accompanying increase in the level of employment. This could be further underpinned by reforming the legislation governing collective labour contracts (*Tarifvertragsrecht*), for example by relaxing the terms of the favourability principle (*Günstigkeitsprinzip*), which currently allows changes to collective labour contracts only if they are in the employees' interests, and also re-attaching a greater weight to the **weapon-of-last-resort principle** (*ultima ratio-Prinzip*) permitting strikes only after all other recourses have been exhausted.

Sustainable social policy

29. In the field of social security 2008 was a year of **half-hearted endeavours**. After all the principal measures aimed at consolidating the statutory pension insurance scheme (G*esetzliche Rentenversicherung*) on a lasting basis were implemented in the period from 2001 to 2007, the Federal Government subsequently sowed the seeds of doubt regarding its resoluteness in respect of pension policy by announcing that the "Riester reform steps" (*Riester-Treppe*), i.e. a rule that dampens pension increases by making a standard deduction for employees' presumed supplementary private pension provision in several incremental steps, would be suspended in 2008 and 2009. The design flaw of the new healthcare fund (*Gesundheitsfonds*) in connection with its rule capping the supplementary contribution payable by individual members of the healthcare institution to cover underfunding (*Überforderungsregel*) was – contrary to the policymakers' better knowledge – not eliminated prior to the Fund's introduction at the beginning of 2009. While the reform of the Public Long-term Care Insurance Scheme (*Soziale Pflegeversicherung*) is a step in the right direction as far as the measures affecting the benefits side is concerned, on the financing side it is no more than a paltry and pusillanimous continuation of the *status quo*.

As the year 2009 will be overshadowed by party political campaigning in the run-up to the national parliamentary elections in September, the most that can realistically be hoped for is that the stipulation, which distorts competition among the individual healthcare institutions (*Krankenkassen*), according to which the social equalisation component (*sozialer Ausgleich*) payable to cover the individual cap on the **supplementary contribution** is to be levied solely on the members of the institution concerned will be replaced by a rule which makes the financing of this social equalisation the responsibility of the Fund as a whole and thus of the entire community of persons insured in the statutory health insurance scheme (*Gesetzliche Krankenversicherung*). Apart from this, the hopes of seeing any substantive resumption of the reform process in the individual social security systems must be put off until after the parliamentary elections.

30. In the area of the statutory pension insurance scheme it is now high time, 20 years after German reunification, for a **statutory equalisation** of the differing regulations regarding **pension level setting and pension adjustment** in eastern and western Germany. The present arrangements are based on the assumption that eastern pension entitlements would automatically rise to the western level by means of a rapid convergence of the east German wage level to that prevailing in western Germany. When, or indeed whether, this will occur is highly uncertain. The process of wage adjustment between the two parts of Germany has been stalling for over ten years now and has given way to a growing heterogeneity of regional wage levels in eastern and western Germany alike. The resulting distribution effects of the differing pension provisions are not only very hard to justify to the insurees, they also contravene the fundamental principles of the statutory pension insurance scheme, namely contributive equivalence (*Beitragsäquivalenz*) and participative equivalence (*Teilhabeäquivalenz*), i.e. the idea that a given level of contributions should result in a corresponding level of benefits and that the relative level of contributions vis-à-vis other contributors should result in a corresponding relative level of benefits. For this reason the German Council of Economic Experts looks in this year's Annual Report at the consequences of the present pension legislation and considers various possibilities for achieving a uniform pan-German solution. The latest point in time for the policymakers to resolve the unequal treatment stemming from the currently valid rules is the year 2019, when the Solidarity Pact II (*Solidarpakt II*) governing fiscal transfers to eastern Germany expires.

Poverty in old age always involves individual cases of hardship, although, measured by the number of elderly people who are currently entitled to claim the basic allowance for aged persons (*Grundsicherung im Alter*), it is not a pressing societal problem at the present time. Nevertheless, the policymakers should concern themselves with finding ways to tackle these risks, which are likely to increase in the medium and long run, in the next legislative period. One thing is sure: it would be quite wrong to backtrack on the policy path embarked upon in recent years in respect of old age provision and to call into question the reforms carried out in the statutory pension insurance scheme and the construction of a funded supplementary private pension component.

31. If the policymakers are not bold and brave enough in the years ahead to use the **healthcare fund** as a springboard for switching to a flat-rate citizens' contribution system (*Bürgerpauschale*), which the German Council of Economic Experts has long advocated and which is a superior concept under growth and employment aspects, they should at least summon up the strength to remain on the route on which they started with the health service reforms of 2003 and 2007 towards intensifying competition among suppliers in order to mobilise existing reserves of efficiency and potential savings. The following three projects should therefore be placed on the agenda of the next health service reform.

− With regard to hospital financing, a changeover should be initiated from the dual system of financing via state government, on the one hand, and the health insurance institutions, on the other, to **a monistic system of financing** so as to overcome the current dualistic generation of excess capacity, insufficient specialisation and dilapidation of clinic buildings.

- The inherently inefficient coexistence of separate sectoral budgets for outpatient and inpatient care should be replaced by a **harmonised system of remuneration embracing all healthcare providers**. Segregated budgets and differences in the sectoral remuneration systems are an obstacle to the optimal integration of cross-sectoral treatment processes.

- The present system of pharmaceuticals **distribution** needs to be modernised by abolishing the anti-competitive prohibition on the extraneous or multiple ownership of pharmacies (*Fremd- und Mehrbesitzverbot*), i.e. the double ownership restriction to pharmacists and to a total of four pharmacies. The policymakers would be well advised to themselves proactively instigate the task of liberalising the distribution of pharmaceuticals rather than waiting until the European Court of Justice compels them to do so.

32. In the **public long-term care insurance scheme** the time window for changing over to a funded citizens' contribution system (*Bürgerversicherung*) is now effectively closed. If the policymakers wish to stick to the present strategy of financing this branch of the social security systems via income-related contributions, the only options left that would help to reduce the intergenerational redistribution effect and to decouple nursing care expenditure from labour costs are the disproportional splitting of contributions between employees and pensioners combined with an expansion of the subsidy system promoting private and company-based supplementary old-age provision to include long-term care provision.

Appendix

I. Tables: Forecasts for 2009

Table A	Key data from the national accounts for Germany
Table B	General Government revenues and expenditures for Germany
Table C	Forecasts for the Labour Market for Germany

II. Law on the Appointment of a Council of Experts on Economic Development

Table A

Key data from the national accounts for Germany
For 2008 estimates, 2009 forecasts

Changes from previous year in %

	2006	2007	2008	2009
Use of domestic product				
Price-adjusted (at previous year's prices)				
Consumption expenditure, in all	0.9	0.2	0.3	0.9
Private consumer spending[1]	1.0	– 0.4	– 0.3	0.4
General government consumer spending	0.6	2.2	2.0	2.2
Gross fixed capital formation	7.7	4.3	4.3	– 2.7
Machinery and equipment	11.1	6.9	5.1	– 6.3
Constructions	5.0	1.8	3.3	– 0.5
Other products	8.0	8.0	7.9	2.6
Stockbuilding[2)3]	0.0	0.1	0.0	– 0.1
Total domestic demand	2.1	1.1	1.1	– 0.1
Net exports[2]	1.0	1.4	0.7	0.0
Exports of goods and services	12.7	7.5	4.2	0.4
Imports of goods and services	11.9	5.0	3.4	0.5
Gross domestic product	**3.0**	**2.5**	**1.7**	**0.0**
Use of domestic product				
at current prices				
Consumption expenditure, in all	2.1	1.6	2.5	3.0
Private consumer spending[1]	2.3	1.4	2.2	2.9
General government consumer spending	1.3	2.4	3.6	3.3
Gross fixed capital formation	8.2	7.2	5.8	– 1.2
Machinery and equipment	9.8	6.3	4.7	– 6.4
Constructions	7.5	8.1	6.6	2.6
Other products	3.9	5.1	5.8	1.9
Total domestic demand	3.1	2.8	3.1	2.1
Net exports	.	.	.	.
Exports of goods and services	14.3	8.0	5.4	1.3
Imports of goods and services	14.9	4.9	6.1	2.6
Gross domestic product	**3.5**	**4.4**	**2.9**	**1.5**
Deflator				
Consumption expenditure, in all	1.1	1.4	2.3	2.1
Private consumer spending[1]	1.3	1.7	2.5	2.4
General government consumer spending	0.7	0.2	1.5	1.1
Gross domestic product	0.5	1.9	1.2	1.5
Total domestic demand	1.0	1.7	1.9	2.1
Origin of national product				
Employment (domestic)	0.6	1.7	1.3	– 0.2
Total number of man-hours worked	0.5	1.8	1.6	– 0.7
Productivity (per hour)	2.5	0.6	0.2	0.6
Distribution of national income				
National income (factor costs)	4.1	3.5	3.3	2.0
Compensation of employees	1.7	3.0	3.7	2.4
of which: net compensation of employees[4]	0.4	3.0	3.5	1.8
Property and entrepreneurial income	8.7	4.5	2.6	1.2
Disposable income of private households[1]	1.9	1.6	2.6	2.5
Ratio of saving of private households[1)5]	10.5	10.8	11.4	11.2
Memo:				
Unit labour costs[6] (Domestic concept)	– 1.2	0.4	1.7	2.5
Consumer prices (Consumer Price Index 2005 = 100)	1.6	2.3	2.8	2.1

1) Including private non-profit institutions.– 2) Contributions to changes in real GDP (percentage of real GDP in previous year).– 3) Including acquisition less disposition of valuables.– 4) Net wages and salaries.– 5) Saving as a percentage of disposable income plus pension funds reserves less private consumption expenditures.– 6) Compensation of employees per employees in relation of gross domestic product (price-adjusted) per persons engaged.

Table B

General Government revenues and expenditures for Germany[1)]

For 2008 estimates, 2009 forecasts

	2007	2008[2)]	2009[2)]	2008[2)]	2009[2)]
	Euro billion[3)]			Changes from previous year in %	
Revenue	**1 065.9**	**1 091.6**	**1 116.4**	**+ *2.4***	**+ *2.3***
of which:					
Taxes	576.3	593.1	607.8	+ *2.9*	+ *2.5*
Social security contributions	399.9	407.5	417.4	+ *1.9*	+ *2.4*
Expenditure[2)]	**1 070.1**	**1 093.1**	**1 121.9**	**+ *2.1***	**+ *2.6***
of which:					
Intermediate consumption	101.9	105.6	110.5	+ *3.6*	+ *4.7*
Compensation of employees	168.0	173.2	178.5	+ *3.1*	+ *3.1*
Income from property (pay out)	67.4	70.0	70.8	+ *3.9*	+ *1.1*
Transfers (pay out)[2)]	660.1	673.5	692.5	+ *2.0*	+ *2.8*
Gross capital formation	35.6	37.7	39.8	+ *6.0*	+ *5.5*
Others	37.1	33.0	29.8	*X*	*X*
Net lending[2)]	**– 4.2**	**– 1.5**	**– 5.5**	***X***	***X***
Memo:					
Expenditure ratio[4)]	*44.2*	*43.8*	*44.3*	*X*	*X*
Tax ratio[4)]	*24.3*	*24.3*	*24.5*	*X*	*X*
"Abgaben" - ratio[4)]	*39.8*	*39.6*	*40.0*	*X*	*X*
Financial balances ratio[2)5)]	– *0.2*	– *0.1*	– *0.2*	*X*	*X*

1) General Government and Social Security Funds according to definitions of the National Accounts. General Government: Federal government, Länder, local authorities including ERP-Special Fund, Care of children development, *Vermögensentschädigungsfonds* and parts of "Federal Railway Trust", "German Unity Fund", "Redemption Fund for Inherited Liabilities".– 2) Potential effects of the financial market stabilisation law are not considered.– 3) Deviations are due to rounding.– 4) Expenditures/taxes and taxes to the EU/taxes and inheritance tax, taxes to the EU and social security contributions/financial balances as a percentage of nominal GDP.– 5) In relation to the GDP in nominal prices.

Table C

Forecasts for the Labour Market for Germany[1)]

For 2008 estimates, 2009 forecasts

	2007	2008[2)]	2009[2)]
		Thousand persons	
Occupied population[3)]	43 296	43 334	43 249
Unemployed persons[4)]	3 602	3 105	3 097
Balance of migrant labour[5)]	74	73	69
Employment (domestic)	39 768	40 302	40 221
Registered unemployment[6)]	3 776	3 268	3 303
of which:			
Former territory of the Federal Republic	2 486	2 147	2 199
New Länder	1 291	1 120	1 105
Memo:			
Employees subject to social insurance[6)]	26 942	27 478	27 427
		Rates (%)	
Unemployment rate[6)7)]	*9.0*	*7.8*	*7.9*
ILO-Jobless rate[8)]	*8.3*	*7.2*	*7.2*

1) Annual averages. – 2) Own estimation; according to definitions of the National Accounts. Deviations are due to rounding. – 3) National concept. – 4) Definitions of the International Labour Organisation (ILO). – 5) Persons engaged (domestic concept) less persons engaged (national concept). – 6) Source for 2007: Federal Labour Agency (Bundesagentur für Arbeit, Nürnberg). – 7) Definitions of the Federal Labour Agency (Bundesagentur für Arbeit). – 8) Unemployed persons in percent of labour force; definitions of the unemployed based on the ILO concept.

II. Law on the Appointment of a Council of Experts on Economic Development

Dated August 14, 1963 (Federal Law Gazette I, page 685)

The Bundestag has enacted the following Law:

Article 1

(1) For the purpose of periodically assessing economic developments in the German Federal Republic, and to assist all authorities responsible for economic policy as well as the general public in forming a sound opinion, a Council of independent Experts is herewith being established.

(2) The Council of Experts consists of five members, who must possess a specialised knowledge of economic science and be experienced in matters of economic policy.

(3) The members of the Council of Experts must not be members of the Government or any legislative body of the Federal Republic or of the Laender, or of the public service of the Federal Republic, of a Land or of some other corporate body under public law, except as a university teacher or an assistant at an institute of economic and social science. Furthermore, they must neither be representatives of any trade organisation, association of employers or trade union, nor may they be bound to them by any permanent contract of employment or agency agreement. Moreover, they must not have held any position of that kind during the year preceding their appointment to the Council of Experts.

Article 2

In its Annual Report the Council of Experts will describe the current economic situation and its foreseeable development. The Council will investigate the possibilities of simultaneously assuring, within the framework of the free market economy, stability of the price level, a high rate of employment and equilibrium in foreign trade and payments, together with steady and adequate economic growth. The investigation will also include the formation and distribution of income and property. The Council of Experts will point out, in particular, the sources of actual and likely tensions between overall demand and supply which endanger the objectives referred to in the second sentence of this paragraph. The investigation is to be based on various assumptions, the different effects of which are to be described and analysed. The Council of Experts will point out undesirable developments and the possibility of avoiding or suppressing such developments, without, however, recommending any specific measures of economic and social policy.

Article 3

(1) The Council of Experts is only bound by the mandate set forth in this law; it is independent in the performance of its work.

(2) If, in the preparation of the report, a minority differs on specific questions, it has the right to express its disagreement in the Report.

Article 4

Before drafting its reports, the Council of Experts may give persons it considers qualified, in particular representatives of economic and social organisations, an opportunity to express their views on essential questions arising within the scope of its commission.

Article 5

(1) If the Council of Experts considers it necessary for the execution of its commission, it may hear the competent Federal Ministers and the President of the German Bundesbank.

(2) At their request, the competent Federal Ministers and the President of the Bundesbank will be heard.

(3) The authorities of the Federal Government and the Laender will furnish the Council of Experts with administrative support.

Article 6

(1) The Council of Experts prepares a report every year (Annual Report) and presents it to the Federal Government by November 15th. The Annual Report is submitted promptly by the Federal Government to the legislative bodies and is published by the Council at the same time. Within eight weeks the Federal Government presents its comments on the report to the legislative bodies. In this statement, the Federal Government presents the conclusions to which it has come with regard to economy policy.

(2) The Council of Experts has to elaborate additional reports whenever there are developments in individual fields which are likely to endanger the objectives referred to in the second sentence of Article 2. The Federal Government may commission the Council of Experts to submit additional reports. The Council of Experts presents the reports in accordance with sentences 1 and 2 to the Federal Government and publishes them; with regard to the date of publication the Council comes to an understanding with the Federal Minister for Economic Affairs.

Article 7

(1) The members of the Council of Experts are nominated by the Federal Government, and appointed by the President of the Federal Republic. On March 1 of every year -the first time after the end of the third year subsequent to the submission of the first report according to Article 6, Paragraph (1), first sentence- one member will withdraw from the Council. The order of withdrawal will be settled by lot at the first session of the Council of Experts.

(2) After nomination by the Federal Government, the President of the Federal Republic will appoint a new member for a period of five years. Re-appointments are allowed. The Federal Government will hear the members of the Council of Experts before nominating a new member.

(3) The members have the right to retire by giving notice to the President of the Federal Republic.

(4) If a member retires before the end of his term, a new member will be appointed for the remaining time. Paragraph (2) will apply accordingly.

Article 8

(1) Resolutions of the Council of Experts must be approved by at least three members.

(2) From among its members, the Council of Experts elects a chairman for a period of three years.

(3) The Council of Experts will establish rules of procedure.

Article 9

The Federal Statistical Office assumes the function of an office of the Council of Experts. Its work will consist in procuring and gathering source material, attending to the technical preparation of the Council of Experts` sessions, printing and publishing the Council's reports, and performing such other administrative work as may be required.

Article 10

The members of the Council of Experts and the staff of its office are bound to secrecy concerning the Council's conferences and the data of these conferences labelled as confidential by the Council of Experts. The duty of secrecy applies also to information received by the Council of Experts and labelled as confidential.

Article 11

(1) The members of the Council of Experts will receive lump sum remuneration as well as reimbursement of travelling expenses. The amounts to be paid will be determined jointly by the Federal Minister for Economic Affairs and the Federal Minister of the Interior.

(2) The remuneration and expenses of the Council of Experts will be borne by the Federal Government.

Article 12

According to Article 13, Paragraph (1), of the Third Law for the Transference of Burdens and Covering Resources to the Federal Republic, of January 4, 1952 (Federal Law Gazette I, page 1), this Law applies to the Land Berlin as well.

Article 13

This Law becomes effective on the day following its announcement.