Public finances*

General government budget

Dramatic deterioration in public finances in 2009

The state of public finances is deteriorating dramatically in the current year. Whereas a virtually balanced general government budget was recorded for 2008, this year's deficit is likely to rise above 3% of GDP and thus exceed the ceiling stipulated in the EC Treaty. This is due, on the one hand, to the direct impact of the cyclical downturn on public finances. It should be borne in mind, however, that gross wages and salaries as well as private consumption, which are of particular significance for public finances, are currently experiencing a far less unfavourable development than GDP and that growth in unemployment is likely to remain limited on an annual average. Nevertheless, there are indications of an exceptionally sharp decline in revenue from profit-related taxes, which is significantly steeper than the regular macroeconomic reference variable would suggest and should be regarded as a countermovement to the unusually strong growth of the past few years. On the other hand, extensive deficit-increasing measures (especially the fiscal stimulus packages), equivalent to a total volume of around 1¼% of GDP in 2009, are having an impact. Government debt will shoot up to €1¾ trillion and could reach almost 75% of GDP. As well as the substantial deficit, both the fall in nominal GDP and measures supporting financial institutions that have no impact on the deficit are also

* The "General government budget" section starts with an analysis based on data contained in the national accounts and on the Maastricht ratios. The subsequent reporting on budgets of the various levels of government and social security schemes is based on the budgetary figures as defined in the government's budgetary financial statistics.

playing a role in this respect (see also Annex on page 77).

Clear decline in revenue but ...

Government revenue will fall markedly this year. Although key macroeconomic variables are developing less unfavourably than the rapidly declining GDP, the sharp cyclical downturn is having a clear impact. Another factor is the expected exceptionally steep decline in revenue from profit-related taxes. Moreover, tax cuts – particularly the changes to income tax rates and to the tax depreciation rules contained in the stimulus packages as well as the additional tax relief measures for enterprises adopted in July – are leading to revenue shortfalls. In the area of social contributions, by contrast, legislative changes will have virtually no net impact as the lower contribution rate to the Federal Employment Agency will virtually be offset by higher average annual contribution rates to the statutory health and public long-term care insurance schemes. Furthermore, contribution payments on behalf of unemployed persons and recipients of short-time working benefits are helping to stabilise receipts.

... revenue ratio increasing

All in all, the revenue ratio will rise perceptibly in 2009 as GDP is declining even more sharply than revenue.

Rise in expenditure ratio even sharper

However, growth in the expenditure ratio will be much stronger still. This reflects the impact of weak economic activity both through higher spending owing to unfavourable labour market developments and through the denominator effect of the fall in GDP. Nevertheless, expenditure growth is accelerating again perceptibly over and above the direct cyclical influences. The additional outlays arising from the fiscal stimulus packages alone will come to around ½% of GDP in 2009, the largest areas of spending being the car scrapping incentive, the temporary expansion both of government investment and of active labour market policy measures and the one-off child bonus. Higher expenditure on certain healthcare services and a permanent topping-up of child benefit had already been resolved previously. In addition, spending on old-age provision and public sector payrolls is growing perceptibly faster than in previous years.

Further substantial deterioration in 2010

The public finance situation is likely to take another sharp turn for the worse next year. The debt ratio could rise to around 80%. The deficit ratio may increase again significantly to 6% (as is assumed by the Financial Planning Council). The factors behind this development will be the same as in 2009. First, the cyclical influence will drive up the deficit perceptibly even if the macroeconomic development stabilises, partly because the growth structure – unlike in 2009 – is likely to be rather unfavourable for public finances. Second, fiscal policy measures will lead to a substantial net increase in the deficit. Finally, the weak development in revenue from profit-related taxes is likely to continue. This will probably lead to a marked decline in the revenue ratio. The main measures driving this trend are the greater tax deductibility of contributions to the health and long-term care insurance schemes and the renewed adjustment to income tax rates. By contrast, the expenditure ratio is likely to continue to increase, reaching 50%, even though some of the temporary stimulus measures introduced in 2009 – such as the car scrapping incentive and the one-off child bonus – will have ceased to take effect. Alongside cyclical effects, the rise in expenditure on old-age provision and healthcare, among other things, will be a key factor in this.

Large consolidation requirement ...

Having reported virtually balanced budgets in 2007 and 2008, Germany is rapidly heading for an extremely large deficit ratio, while the debt ratio is set to reach a new high. This reflects the effect of the automatic stabilisers and the fiscal stabilisation measures, the scale of which is justifiable in view of the drastic economic slump. These measures are providing a short-term boost to economic activity. At the same time, however, they are one of the factors behind the substantial consolidation requirement. The deficit forecast for 2010 is actually due only to a minor extent to temporary measures and effects and cyclical factors. Rather, the structural deficits that already existed in 2008 will also be driven up substantially both this year and next by permanent cuts in taxes and social contributions and a perceptible increase in the structural expenditure ratio. Without fiscal consolidation, the general government debt ratio would rapidly expand further, leading – particularly if interest rates start to rise again – to a swift increase in the interest burden. Fiscal policymakers will therefore be confronted with a major consolidation task in the coming legislative period.

... also to comply with national and European budgetary rules

In light of this situation, the new debt rules for central and state government constitute a major step forward. Unlike previous regulations, they stipulate a cyclically adjusted budgetary position that is generally at least close to balance. This means that the national rules are more closely aligned with the obligations of the European Stability and Growth Pact. In order to be sure of achieving this target within the specified transitional periods, considerable efforts are required both on a central government and on a state government level. It is important to remember that, given reduced potential growth, the cyclically adjusted expenditure ratio increases even if expenditure rises only moderately; tight spending curbs are therefore required in order to achieve consolidation via the expenditure side. As the ceiling of 3% of GDP for the general government deficit stipulated in the EC Treaty is likely to be substantially exceeded for a prolonged period of time if no further measures are taken, it can also be expected that an excessive deficit procedure will be initiated against Germany, obliging it to rapidly bring its deficit ratio back below the reference value.

Budgetary development of central, state and local government

Tax revenue

Sharp decline in tax revenue in Q2

In the second quarter of 2009, tax revenue[1] was down by 8% on the same quarter in 2008 (see chart on page 69 and table on page 70). As expected, the decline in revenue was thus much greater than in the first quarter. The economic downturn had an increasing impact, and the various tax relief meas-

1 Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the quarter under review.

ures taken in order to stabilise the economy likewise increasingly led to revenue shortfalls.

Large income tax shortfalls

Revenue from income-related taxes fell by 19%. Wage tax receipts declined steeply, as the development in gross wages and salaries was sluggish and the reduced rates became effective retroactively for the entire first half of the year. Moreover, the amounts deducted from the revenue total increased sharply; the rise in child benefit at the beginning of the year was augmented by the one-off child bonus and the last increment in the subsidies for supplementary private pension plans, the bulk of which were paid out in May. Particularly large shortfalls were recorded for the profit-related taxes. Receipts from corporation tax plummeted owing primarily to lower advance payments for current profits and high refunds for 2008; in addition, large drops in revenue from investment income tax were recorded as a result of lower profit distributions[2]. Receipts from assessed income tax likewise decreased sharply owing to tax refunds following the Federal Constitutional Court's ruling reinstating the standard travel allowance for commuters and to tax relief measures; without these factors they would have remained quite stable.

Increased revenue from consumption-related taxes

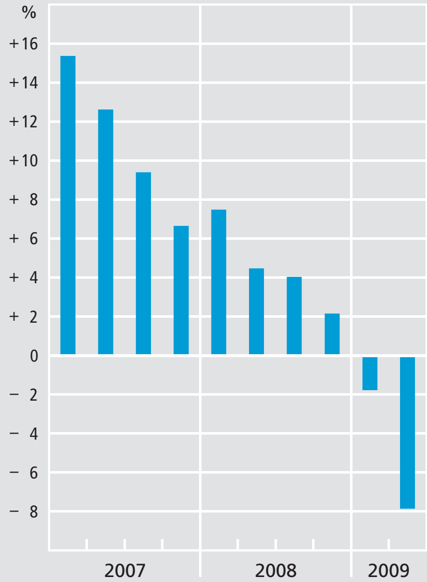
Consumption-related tax revenue, which sometimes swings very erratically from one quarter to the next, experienced a marked rise of 3½%. Combined with the weak first quarter, this amounted to a small increase of ½% in the first six months of 2009.

Clear decline in 2009 as whole

According to the latest official tax estimate in May, a significant revenue decline of almost 6½% is expected for 2009 as a whole (excluding local government taxes) after taking account of the additional tax relief measures for enterprises adopted since then (taxation only of actual turnover revenue, temporary liberalisation regarding purchases of shell companies and the interest payment offset limit, tax relief on agricultural ("red") diesel). Although, taken together, shortfalls owing to tax relief and to tax refunds following the reinstatement of the standard travel allowance for commuters will fall later this year in com-

Tax revenue*

Year-on-year change, quarterly



* Including EU shares in German tax revenue, but excluding receipts from local government taxes, which are not yet known for the last quarters recorded.

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2 Since withholding tax was introduced at the beginning of the year, investment income has generally been taxed at source at a rate of 25%. For private income, this is mostly also the final tax rate; however, particularly for business earnings, refunds and back payments are still made if tax assessments are submitted. Although withholding tax is expected to generate shortfalls overall, the adjustment to investment income tax rates per se is initially leading to windfalls as the extra revenue from the higher tax rate on dividends outweighs the effect of the rate reduction for interest income owing to the larger tax base.

Tax revenue

Type of tax	H1				Q2				Estimate for 2009 [1, 2]
	2008	2009			2008	2009			Year-on-year percentage change
	€ billion		Year-on-year change € billion	as %	€ billion		Year-on-year change € billion	as %	
Tax revenue, total [2]	249.7	237.3	– 12.4	– 5.0	130.8	120.5	– 10.3	– 7.9	– 6.3
of which									
Wage tax	67.5	64.5	– 3.0	– 4.5	34.7	30.5	– 4.2	– 12.2	– 4.2
Profit-related taxes [3]	42,2	34,0	– 8.1	– 19.2	25.3	18.0	– 7.3	– 28.8	– 23.6
Assessed income tax	14.1	12.1	– 2.0	– 13.9	10.4	9.1	– 1.3	– 12.1	– 30.1
Investment income tax [4]	18.5	17.2	– 1.3	– 7.3	10.1	8.5	– 1.5	– 15.3	– 11.2
Corporation tax	9.5	4.7	– 4.8	– 50.3	4.8	0.3	– 4.5	– 92.9	– 33.6
Turnover taxes [5]	86.2	86.5	+ 0.3	+ 0.4	41.9	43.4	+ 1.5	+ 3.7	– 0.6
Energy tax	14.2	14.8	+ 0.6	+ 4.2	9.6	10.1	+ 0.5	+ 5.1	– 3.6
Tobacco tax	5.8	5.9	+ 0.1	+ 1.9	3.3	3.6	+ 0.3	+ 9.0	– 1.4

1 According to official tax estimate of May 2009, additionally including legislative changes adopted in the meantime (Citizens' Relief Act Governing Health Insurance, Act Amending the Energy Tax Act). — **2** Including EU shares in German tax revenue, but excluding receipts from local government taxes, which are not yet known for the last quarter recorded. — **3** Employee refunds, grants paid to home owners and investors deducted from revenue. — **4** Withholding tax on interest income and capital gains, non-assessed taxes on earnings. — **5** Turnover tax and import turnover tax.

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parison with the second quarter, there is likely to be a weaker momentum in wages and employment. All in all, however, forecasting uncertainty is currently very high.[3]

Central government budget

Smaller surplus in Q2

While the central government budget recorded a surplus of €2½ billion in the second quarter of 2009, this was lower than the positive balance reported a year earlier (€4½ billion). Revenue fell by just under 2½%. This was chiefly due to the fall in tax receipts which, however, were stabilised perceptibly by significantly lower contributions to the EU, which are offset against tax revenue. While expenditure grew by barely ½%, this was deceptively low. Adjusted for the windfall effect amounting to €2 billion arising from the changed payment deadline for regular grants to the Federal Employment Agency, the rise came to just over 3%.

Jump in deficit in second supplementary budget due to tax revenue shortfalls and ...

The second supplementary budget adopted following the May tax estimate envisages a further increase of €12 billion in net borrowing vis-à-vis the first supplementary budget passed in February in connection with the second fiscal stimulus package. Net borrowing is thus now forecast to total around €49 billion this year. The ceiling of just under €33 billion arising from the pegging of net borrowing to planned investment expenditure laid down in Article 115 of the German Basic

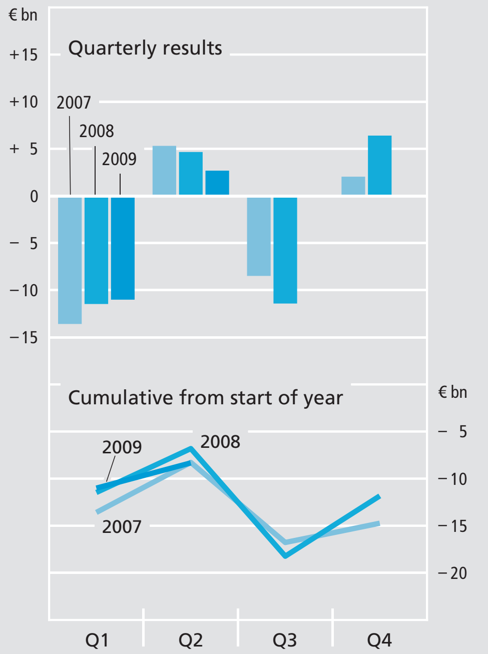
3 See also Deutsche Bundesbank, Development of tax revenue in Germany and current tax policy issues, Monthly Report, October 2008, pp 33-57.

Law will be exceeded by an even greater amount by invoking the exemption clause that this is warranted by the need to avert a disruption to the overall economic equilibrium. The budget covers revenue shortfalls of €8 billion projected in the latest tax estimate and of €1½ billion owing to additional temporary tax relief measures. By contrast, a windfall of almost €3 billion will ensue, via a retransfer from the Redemption Fund for Inherited Liabilities, from a one-off decision that the Bundesbank's entire profit – and not just the share exceeding the threshold of €3½ billion to be transferred to the Redemption Fund – will be booked to central government and appropriated in its budget. The envisaged additional expenditure is largely necessitated by a loan to the health insurance fund (€4 billion) and benefits for the long-term unemployed (€1½ billion). Revenue is now predicted to decline by just over 6% overall (€16½ billion, of which €15 billion are tax shortfalls) in 2009 compared with the actual outturn for 2008 and expenditure to increase by 7½% (€21 billion, of which €8½ billion relates to spending on the statutory health insurance scheme and €3 billion results from long-term unemployment). Budgetary burdens that are not yet covered, eg a decline in receipts from motorway tolls and CO_2 emission rights caused by the recession, could be accommodated from today's perspective by cautious budgeting, such as in the estimated central government loans to the health insurance fund.

... additional spending

Central government's draft budget for 2010 foresees net borrowing ballooning by a further €37 billion to €86 billion next year, based

Central government fiscal deficit/surplus



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Renewed dramatic rise in new borrowing in 2010 draft budget

once again on the justification of a disruption of the macroeconomic equilibrium. Expenditure is forecast to increase again sharply by 8% (€24½ billion) compared with the second supplementary budget for 2009. On balance, this is due almost entirely to additional unemployment-related costs, including spending of €20 billion on a loan to the Federal Employment Agency and of €3½ billion on unemployment benefit II and related payments. The grant to the statutory pension insurance scheme is set to increase in the wake of the growth in average remuneration in 2008 (€1½ billion), while payments to the health insurance fund will rise only marginally on the year as the sizeable upping of the regular grant will be practically offset by the dropout of the loan granted to it in 2009. By contrast, interest expenditure is estimated to be just

Central government's medium-term financial plan

€ billion

	Actual 2008	Target 2009 3	Draft 2010	Financial plan 2011	2012	2013
Expenditure 1	282.3	303.3	327.7	321.1	318.3	313.5
of which Investment	24.3	32.8	48.6	43.3	39.1	35.0
Revenue 1, 2	270.7	254.2	241.6	249.4	259.6	267.6
of which Taxes 1	239.2	224.1	213.8	221.9	232.4	240.6
Privatisation proceeds	6.7	2.0	2.3	3.3	3.6	3.6
Net borrowing	11.5	49.1	86.1	71.7	58.7	45.9
Memo item Percentage increase in expenditure	4.4	7.4	8.0	– 2.0	– 0.9	– 1.5

1 After deduction of supplementary central government grants to state government, of shares in revenue from energy tax and of compensation in connection with the 2009 motor vehicle tax reform. — **2** Including proceeds from coin seigniorage. — **3** Pursuant to the second supplementary budget.

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over €2 billion lower owing largely to the non-recurrence of one-off payments incurred this year by the special fund for the redemption of inflation-indexed government debt instruments and to substantial refinancing savings. Revenue will slide by a further 5% (€12½ billion), mainly on account of falling tax receipts (-4½% or €10 billion, of which around €6½ billion will be incurred by permanent relief measures in the form of tax allowances for insurance contributions and lower income tax rates) and the dropout of the extra proceeds from the Bundesbank's profit distribution.

New financial plan shows big consolidation need

Pursuant to the new debt rules adopted in June,[4] central government's structural net borrowing (net borrowing adjusted for a cyclical component and financial transactions) is to be reduced in equal annual steps between 2011 and 2016 to the then permissible ceiling of 0.35% of GDP. The path to consolidation is mapped out in the new medium-term financial plan until 2013. After deducting net financial transactions[5] amounting to €21 billion and the estimated cyclical component of €26 billion, the structural component of the 2010 deficit is estimated to be €39½ billion or 1.6% of GDP. This means that annual structural reductions of 0.2 percentage point (around €5 billion) will be required during the transitional phase. As net financial transactions and the cyclical component are likewise expected to fall, the new medium-term financial plan envisages that net borrowing will decrease by up to €14½ billion (½% of GDP) per year to €46 billion in 2013. However, the planned reduction is based solely on global, non-specific cost savings – growing from €5 billion in 2011 to 18½ billion by 2013 – rather than on specific consolidation measures. If this global figure is factored out, the structural deficit will actually increase further by then (see chart on page 73).

Consolidation required in next legislative period

There will therefore be a considerable need for consolidation in the next legislative period, which could become larger still if the cyclical component were to be revised in the remainder of the year and assessed as being notably less negative.[6] Owing, not least, to the uncertainties surrounding estimations of the cyclic-

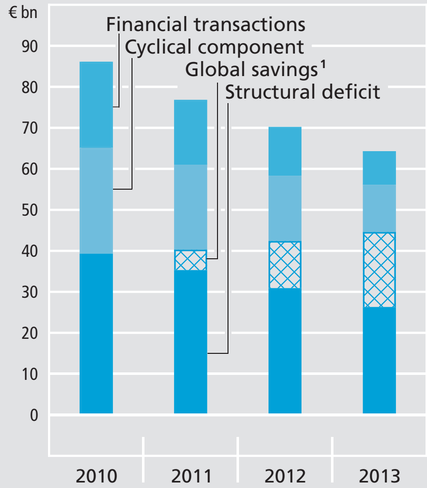
4 See also Deutsche Bundesbank, The reform of the borrowing limits for central and state government, Monthly Report, May 2009, pp 78-79.
5 Granted and repaid loans as well as acquisitions and sales of participating interests are considered to be financial transactions.
6 This is suggested inter alia by the European Commission's spring estimate up to 2010.

ally adjusted budgetary position, it would thus seem wise to plan in a safety margin below the 0.35% ceiling.[7] As things stand, therefore, there will be no leeway for unfunded deficit-increasing measures in the coming years.

Off-budget entities with large deficits

In addition to the expected substantial deficit in the core budget, central government's off-budget entities are also likely to record very large deficits in 2009. They ran up a deficit of €15 billion in the first half of this year, compared with a surplus of €1½ billion in the same period last year. The Financial Market Stabilisation Fund (Soffin) alone recorded a deficit of €13½ billion in the first six months of 2009 owing to sizeable capital injections into credit institutions. By contrast, the Investment and Repayment Fund, which now has expenditure authorisations totalling €25 billion, recorded a deficit of only €1 billion, which was almost entirely attributable to the car scrapping incentive. The outflow of investment funds will probably rise significantly by the end of the year, as an increasing number of projects will be initiated and funded. Overall, the off-budget entities could record a deficit of €25 billion in 2009.

Net borrowing plus global savings in central government's medium-term financial plan



1 Excluding the estimates for financing the resolutions envisaged in the Higher Education Pact (€2½ billion), which are not attributed to individual years from 2011 to 2013.

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personnel expenditure increased significantly as a result of the pay settlement for salaried staff concluded in March and its extension to public sector employees with civil servant status as well as retired civil servants in most federal states. These figures exclude the substantial capital injection of €3 billion into HSH Nordbank financed outside the core budgets of Schleswig-Holstein and Hamburg.

State government[8]

Deterioration in fiscal balance continued in Q2

The deterioration in the fiscal balance of state government continued in the second quarter. After recording a surplus of €6½ billion last year, state governments posted a deficit of €2½ billion this time. Revenue fell sharply by 9% owing primarily to the steep decline in tax receipts. Spending rose by 3½%. Not least,

Large full-year deficit expected

The current state budgets, most of which take account of the second economic stimulus package but have not yet been fully adjusted to the latest – less favourable – tax esti-

7 See Deutsche Bundesbank, The reform of the borrowing limits for central and state government, Monthly Report, May 2009, pp 78-79.
8 The development of local government finances in the first quarter was analysed in greater detail in the short articles in the Bundesbank Monthly Report of July 2009. These are the most recent data available.

mate, already project a deficit of €22 billion for 2009. However, this does not include the €7 billion injected into Bayern LB, which was allocated to the 2008 budgetary accounts, or – as in the case of HSH Nordbank – the planned capital injection of €2 billion into LBBW by Baden-Würtemberg.

Implementation of debt rule still largely unclear

Against the backdrop of ongoing large deficits through 2010 and beyond and the foreseeable sharp rise in state civil servant pension obligations, it is imperative to rapidly consolidate state government budgets once the crisis has been overcome – even though the new debt rule will not have full binding effect on state government until 2020. The rule stipulates that, as a general principle, state government budgets must be balanced. However, the German constitution (Basic Law) does not specify that state governments should adjust their borrowing limit for financial transactions and cyclical influences or how they should handle infringements of the borrowing limit, and these matters seem, as yet, to be largely unresolved. It would therefore appear sensible to enshrine these points in the state government constitutions. A uniform and transparent procedure would facilitate monitoring of budgetary developments by the new Stability Council, which will begin work as early as 2010, and by the general public. Prompt decisions would be desirable in order, among other things, to be able to quantify the consolidation requirement for the individual states and plan corrective measures as soon as possible.

Social security funds[9]

Statutory pension insurance scheme

Financial development in Q2 still robust

The surplus of €½ billion recorded by the statutory pension insurance scheme in the second quarter of 2009 was down by one-half on the year. Both total revenue and contributions grew by just under ½%. Although employees' compulsory contributions (including contributions for recipients of short-time working benefits) fell by ½%, contributions for recipients of unemployment benefits were up by one-fifth on the year. This illustrates that falling employment will cause only a moderate decline in revenue to the statutory pension insurance scheme as long as unemployment benefit I or short-time working benefits are being paid. Should unemployment become more deeply entrenched, however, revenue can be expected to shrink more sharply.[10] Expenditure was up by 1½% on the year. This was caused primarily by a rise of just under 1½% in pension payments, resulting from the pension increase of 1.1% in mid-2008 and marginal growth of just under ½% in the number of pensions. In addition, health insurance contributions for pensioners grew markedly following the launch of the health insurance fund on 1 January 2009

9 The financial development of the statutory health and public long-term care insurance schemes in the first quarter was analysed in the short articles of the Monthly Report of June 2009. These are the most recent data available.
10 For each recipient of unemployment benefit I the Federal Employment Agency transfers social contributions on the basis of 80% of his/her previous gross remuneration (averaging just over €2,500 per month in western Germany and just under €2,200 in eastern Germany). If the recipient subsequently claims (means-tested) unemployment benefit II, the assessment base decreases to €205 per month.

with a uniform contribution rate of 15.5% (compared with an average of 14.9% a year earlier).

Financial deterioration over remainder of 2009

The revenue base is likely to weaken further in the second half of the year owing to the economic crisis. Moreover, pensions were raised very sharply on 1 July 2009 – by 2.41% in western Germany and 3.38% in eastern Germany. This is due, first, to last year's strong growth in earnings subject to contributions and, second, to the renewed suspension of the factor dampening pension increases through a standard deduction for contribution payers' assumed own supplementary old-age provision ("Riester reform steps"). This added just over 0.6 percentage point to the pension increase.[11] The cut in the contribution rate to the health insurance fund in mid-2009 to 14.9% will provide some, albeit significantly smaller financial relief.

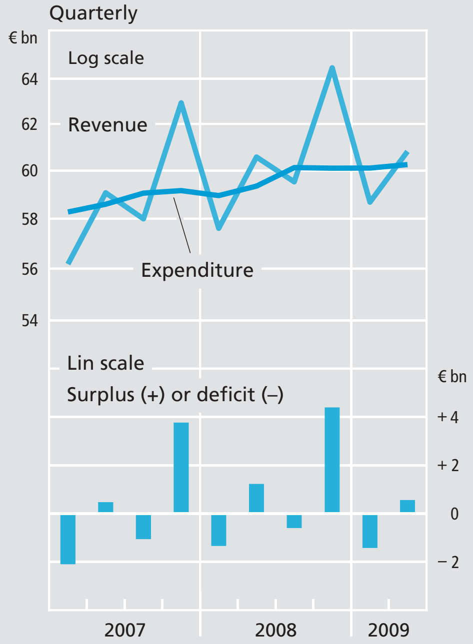
Federal Employment Agency

Agency's financial situation again worse

The Federal Employment Agency recorded a deficit of almost €6 billion in the second quarter. This equates to a year-on-year deterioration of €5½ billion and reflects both the impact of the macroeconomic downturn and special factors. Total receipts fell by one-third, which was attributable in no small measure to the renewed lowering of the contribution rate from 3.3% to 2.8% and, to an even greater extent, to the fact that the Federal grant (just under €8 billion per year or previously almost €2 billion per quarter) is no longer transferred in equal monthly instalments but as a one-off payment at the end of the year. But even without these two extraordinary factors, revenue would have fallen by just over 2½% in the second quarter.

Finances of the German statutory pension insurance scheme

Quarterly



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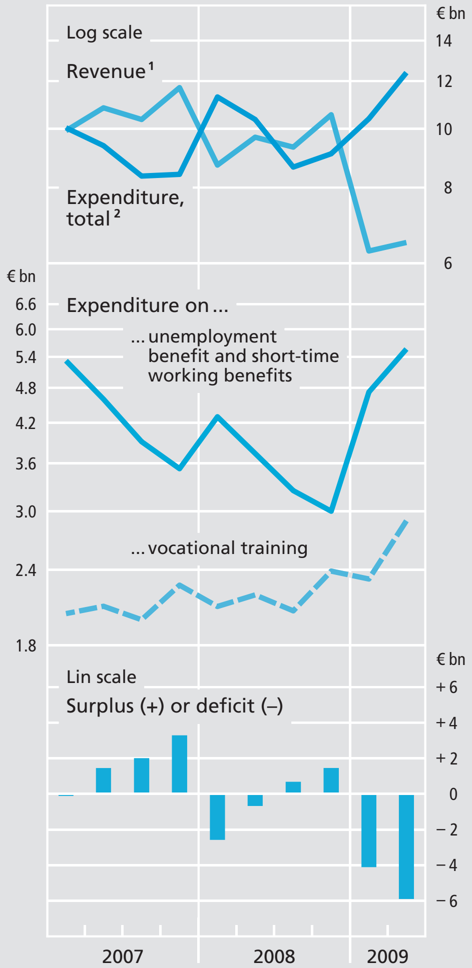
Recession driving up Agency's costs

Expenditure growth likewise reflects the increasing impact of the macroeconomic slowdown on the labour market and, additionally, the sharp increase in the implementation of vocational training measures. Furthermore, claiming short-time benefits has temporarily become much more appealing for firms and thus more

11 In order nonetheless to achieve the aspired objective of curbing the increase in contribution rates, legislation is planned to retroactively claw back the suspended pension modifications as well as the pension decreases waived in recent years. If the existing rules are applied, this means that hardly any pension increases are to be expected in the coming years.

Finances of the
Federal Employment Agency

Quarterly



1 Excluding central government liquidity assistance. — 2 Including transfers to the civil servants' pension fund set up in 2008.

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costly for the Agency.[12] Spending consequently soared by 19½% (€2 billion) in the second quarter. The higher payments for short-time working benefits, unemployment benefit I and active labour market policy measures were a key factor behind this. In addition, insolvency benefit payments grew substantially.[13]

Including the unscheduled expenditure approved recently, the Federal Employment Agency is expected to record a deficit of €16½ billion for the year as a whole. Its reserves would then be almost completely exhausted by as early as the end of 2009. In particular, the funds earmarked for short-time working benefits were adjusted given the increased recourse to this facility and the most recent benefit extensions, though the estimates for unemployment and insolvency benefits were likewise revised upwards significantly.

Large deficit in 2009 with stabilising function

Should unemployment increase, the deficit can be expected to rise next year. Given the depletion of the Federal Employment Agency's own reserves, this will need to be offset using central government funds. In the draft Federal budget for 2010, the sum of €20 billion – above and beyond the regular Federal grant of just under €8 billion – is envisaged for a loan. The loan will be interest-free and will not need to be repaid until the Federal Employment Agency records sufficient surpluses. Since it will hardly be possible for the Agency to achieve a structurally balanced budget with a contribution rate of 2.8% (or 3.0% from 2011), it will probably be unable to repay the central government loans under these conditions.

Central government loan required in 2010

12 In principle, social contributions – based on 80% of the salary lost due to short-time working – are to be paid by the employer. The second economic stimulus package stipulated that the Federal Employment Agency would refund 50% of these costs or 100% if the firm provides retraining. It was recently decided that social contributions for recipients of short-time working benefits would be refunded in full from the seventh month of short-time working regardless of whether retraining measures are in place. In addition, the maximum period of entitlement to short-time working benefits was extended initially from 12 to 18 months and, from 30 April, to 24 months.
13 In the first half of the year, only one-half of this expenditure was covered by the insolvency benefit contributions paid by enterprises. The contribution rate is based on the original budget plan. It is adjusted for actual expenditure in the following year.

Annex

Statistical recording of financial market stabilisation measures in connection with the Maastricht deficit and debt levels

The numerous, predominantly government measures taken to support financial institutions during the financial crisis are raising questions about how they should be recorded in the EU statistical systems. Whether and to what extent the measures taken are reflected in the member states' deficit and debt levels ultimately depends on how such government interventions are evaluated.[14] The task of statistical recording is additionally hampered because the various stabilisation instruments that have been devised to date are very diverse and in some cases very complex and because attempts to determine the actual value of the financial assets in question are fraught with much uncertainty. The most commonly deployed measures include capital injections, guarantees, loans and the purchase of impaired assets. Additional instruments relate to providing banks with government bonds eligible for refinancing purposes. Constructs involving the setting-up of special entities charged with carrying out the support measures are particularly intricate. Thus support measures may be carried out not just by dedicated government special funds but also by public enterprises and special purpose vehicles set up under private law in which the state holds no majority stake but provides a risk shield.

The need for accurate and timely recording of public finance statistics is particularly great in the euro area as a solid and transparent statistical base is a key prerequisite for ensuring the effectiveness and credibility of the European fiscal rules. The latter are intended to safeguard the sustainability of public finances in the EU and in the euro area. The EU has an established institutional framework for statistics. As the European Commission's statistical office, Eurostat is responsible for providing and assessing the quality of data used in the EU budgetary surveillance procedure. In addition, Eurostat is charged with the task of clarifying any unresolved issues with regard to applying the accounting rules of the current European System of Accounts (ESA 95), which must be used for calculating the Maastricht deficit and debt levels. In complicated cases or those that are of general interest, the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB) should first be consulted. The CMFB is a committee of experts and as such enjoys the status of an advisory body. Expert opinions issued by the CMFB based on consultation procedures are intended *inter alia* to lend rapid and independent technical support to Eurostat's decision-making process and protect it against political lobbying.[15] In accordance with the European Statistical System (ESS) Action Plan published by Eurostat, care must be taken when interpreting the ESA 95 rules to ensure that consistency is maintained both over time and between member states.

The CMFB published two opinions on 18 March 2009 providing clarification of key statistical accounting aspects associated with government intervention to support financial institutions and financial markets during the financial crisis.[16]

14 See also Deutsche Bundesbank, The impact of the financial market crisis on public finances, Monthly Report, November 2008, pp 64 and 65.
15 See the ECOFIN Council conclusions of 8 November 2005.
16 See CMFB website (www.cmfb.org), opinions from 18 March 2009.

Ahead of the notifications by member states before 1 April, Eurostat welcomed these opinions as a suitable approach to recording statistics in the absence of corresponding guidelines of its own. On 15 July 2009, Eurostat published a decision and a technical guidance note.[17] It concluded that the exceptional situation of the financial crisis raises particular challenges for statisticians, above all, concerning the valuation of financial assets, the measurement of risks and the rapid development of new forms of intervention. With this in mind, Eurostat compiled a set of rules which explicitly apply only to the unique circumstances of the financial crisis. Given the individuality and complexity of the transactions, a need for specific clarification and interpretation in individual cases will persist, however.

In principle, special rules for recording support measures in this exceptional financial crisis are justified *inter alia* by the fact that market values, which for example would be needed to determine a possible capital transfer share (to be recorded as deficit-increasing) if transaction values deviate, can no longer be reliably determined as a result of the uncertainty surrounding asset values. In such cases, the recording guidance to resolve valuation problems established by Eurostat on the basis of the CMFB opinions provides a working approximation to the valuations required. In a departure from the ESA 95 provisions and the CMFB recommendations, the rules regarding the basic definition of the general government sector have been amended and the fundamental principle of recording according to economic substance rather than form has been partially abandoned. Consequently, it is conceivable at present that similar support measures may be treated differently depending on their form. This also runs counter to the objective stated in the action plan that all member states should record statistics consistently both over time and between countries. In this context, it is worrying that – in contrast to the CMFB vote and transactions that have already been recorded – in individual countries certain transactions are now to be recorded as not increasing the deficit or debt level.

On the whole, it is expected that the current government support measures, which are likely to place considerable financial burdens on the state,[18] will to a large extent initially not be reflected in the officially published Maastricht deficit level and only to some degree in the Maastricht debt level.

Asset purchases by government

If government purchases securities from financial institutions at a higher price than the current market price, ESA 95 stipulates that the difference should be recorded as a capital transfer that increases the deficit. All other things being equal, such a purchase – which is typically debt-financed – would push up the Maastricht debt level, which is calculated as gross indebtedness (excluding the deduction of government financial assets). At present, when actually recording these purchases, the problem may arise that the market price is either not known or cannot be determined. Recourse must then be made to alternative valuation approaches in order to record these in the statistics. Broadly following the CMFB opinion, the Eurostat decision specifies how market prices can be approximated during times of financial crisis. If the capital markets in question are inactive, a first possible approximation would be the value deter-

17 See http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home.
18 See *inter alia* European Commission, Public Finances in EMU 2009, European Economy 5/2009.

mined during an auction procedure. If there are no auction prices, then the last book value can be used if this is a fair value as defined in international accounting standards and if it was calculated shortly after the government purchase. If these requirements are not met, then the price to be used should be determined by means of independent valuation (in accordance with market-based methods). If a price cannot be calculated in this way either, the final option would be to use the transaction price. In this case, however, a (retroactive) correction would have to be made subsequently if the assets are revalued in the following year or sold on at a lower price and the market environment has not changed significantly in the meantime. Finally, if and when the asset is sold on at an even later date at less than the recorded purchase price, the resulting negative difference is also to be recorded as a deficit-increasing capital transfer if the valuation at the time of purchase was based on book values (fair value), on independent market-based valuation methods, or on transaction values.

Recapitalisation of financial institutions

When recording capital transfers by government, the issue generally arises as to whether government invests funds in the same way as a private investor, ie in anticipation of a market rate of return, or whether government instead offsets incurred losses for other reasons. As a rule, financial transactions, such as the acquisition of shares, are recorded at the transaction value in the national accounts. However, if a transaction is not just commercially motivated but also contains a transfer component, it should be recorded accordingly. For instance, if government were to purchase, as part of a capital increase, new quoted equity above the current market price, the difference would have to be recorded as a deficit-increasing capital transfer. This is likely to be the case, for example, for the Financial Market Stabilisation Fund (Soffin)'s topping-up of its equity holding in Hypo Real Estate to 90% in June 2009. The assessment becomes more difficult if the capital injection takes the form of unquoted preference shares or other hybrid instruments. Given the prevailing uncertainty surrounding asset values during the financial crisis, Eurostat resolved, in accordance with the CMFB's recommendations, that government capital injections in the form of preference shares for which a return has been agreed in line with current EU state aid rules are to be treated as normal financial investment (ie they have no impact on the Maastricht deficit). However, the Maastricht debt level would increase *ceteris paribus* due to refinancing requirements. Given the current valuation uncertainty, this can be understood as an exceptional rule that is acceptable as a working approach. Nevertheless, as things currently stand, this is likely to understate the present burden as capital injections to stabilise credit institutions granted in the context of an approved state aid typically also contain a subsidy component.

Delimitation of the general government sector – recording newly set up financial vehicles

Pursuant to ESA 95, entities that do not have sufficient decision-making autonomy in respect of exercising their principal function should be consolidated with the entities that determine their general business policy. Decision-making autonomy means not just the formal recording of assets on a balance sheet but also being entitled to exchange ownership of these in transactions with third parties. As a rule, the activities of financial vehicles set up with state backing for the sole purpose of rescuing distressed financial institutions or supporting the financial sector in the throes of the financial turmoil are largely predetermined by government and the entities themselves thus have no sufficient autonomy of decision in respect of exercising their principal function. Similarly, it seems clear that government determines the general business policy of such an entity which it guarantees and therefore largely controls this entity. ESA 95 expressly stipulates that government may also enjoy a corresponding control – eg owing to special legislation, decree or regulation – without necessarily being the majority stakeholder. Financial vehicles established to support the financial sector under terms specified by government and whose existence and activities would not be possible without a government guarantee can hardly be regarded as financial intermediaries given the lack or considerably restricted possibility of risk assumption. Moreover, they usually have neither a banking licence nor a notable capital base. Consequently, the special purpose vehicles set up to support the regional wholesale banks (*Landesbanken*) SachsenLB and WestLB have been recorded inside the general government sector in the German national accounts. There is also no doubt that Soffin must be classified under the government sector. In its opinion, CMFB recommends assigning financial vehicles to the general government sector if they can be registered as an institutional unit and if the majority of their shares is held by non-government units, but their activities are predetermined by government and for which government bears the brunt of the risks (for instance, by guaranteeing their refinancing).

According to the Eurostat decision, by contrast, the key factor for determining to which sector a special purpose vehicle should be assigned is whether the majority stake is held by government or non-government units. This diverges from the concept of control defined in ESA 95 outlined above and could result in a sectoral classification which is at odds with economic reality. However, the Eurostat decision should not be taken to mean that all special purpose vehicles set up in connection with the financial crisis and where the majority stakeholder is a non-government unit are to be recorded outside the government sector. The new rules specify that this is the case only if the entity has been established to operate only for a short period of time (ie for the duration of the financial crisis) and if losses are expected to be low relative to total debt. To estimate the expected losses, Eurostat proposes considering the quality of the collateral or of any other arrangements that limit liability. This appears to be difficult, however, especially as it is precisely in times of financial crisis that it is difficult to determine the true value of financial assets. In the case of existing special purpose vehicles for *Landesbanken* and of the bad bank models pursuant to the Financial Market Stabilisation Amendment Act of 17 July 2009, however, these entities would be classified under the government sector on the basis of the duration criterion alone as these have apparently been set up to operate for a considerable period of time. On the whole, these additional criteria provide only a limited approach to deciding the sectoral assignment of entities which is neither derived from ESA 95 nor is consistent with the CMFB's recommendations.

Guarantees

Pursuant to ESA 95, guarantees – unless they are tradable or can be offset on the market and thus have a market value – are contingent liabilities and as such are not counted towards the debt level. Government guarantees granted in connection with the financial crisis may comprise deposits, debt instruments or financial assets, for example. Guarantees granted to entities assigned to the government sector have no impact on the (consolidated) government sector even if they are called. For all other support measures designated as guarantees, however, a case-by-case decision must be made as to whether this labelling is in line with the ESA 95 provisions.

Support measures provided via public enterprises

In the case of the support measures taken by the KfW Banking Group in 2007 to support IKB (in particular, assumption of the obligations to the Rhineland Funding conduit), Eurostat initially decided that these transactions clearly ran counter to KfW's own economic interests and that this is a material indication that KfW acted on behalf of government. Furthermore, the general notion was confirmed that the measures were taken for the public benefit, so that ultimately government (and not KfW) was to be regarded as the principal party to the transaction. To capture the economic reality behind a transaction more accurately, ESA 95 stipulates that the transaction is to be recorded in the accounts of the principal party to the transaction. In the case of public enterprises, in particular, Eurostat has carefully examined in the past whether certain transactions which transcend normal business activities may have been carried out on behalf of government. On the basis of a Eurostat decision, Germany therefore initially assigned the transactions of €7.3 billion net made by KfW in 2007 to the government deficit. However, pursuant to the latest Eurostat decision, which follows the CMFB opinion on this point, a written instruction or irrefutable evidence proving that KfW acted on government instructions would be required for the transaction to be classified as increasing the deficit. The support measures undertaken by KfW in 2007 thus ought to be subtracted from the general government deficit. However, the measures taken by KfW in 2008 to support IKB (in particular, recapitalisation) would remain assigned to the government sector because a corresponding provision had been made for this in the budget, thus proving that this action was undertaken on behalf of government.

Exchange and loan of financial assets

To safeguard banks' liquidity, they can temporarily be offered government bonds in exchange for non-eligible securities. It is questionable whether the transfer of government bonds on a temporary basis – albeit for a significantly longer period than is usual for securities lending transactions – has to be included in the calculation of the Maastricht debt level or whether the securities remain in the government's portfolio (as lender) as with conventional securities lending transactions, thereby having no impact on outstanding government debt. The Eurostat decision states that the way in which the transactions are recorded depends, first, on the duration of the transaction and, second, on the risks which the transactions entail for government. However, the latter are likely to be difficult to assess given the current extreme uncertainty. Moreover, the duration of the transaction is not specified and thus requires further clarification.