

Public finances*

General government budget

Germany's public finances will deteriorate considerably again this year owing to the expansionary fiscal policy stance. The deficit ratio is continuing to increase noticeably from its level of 3.1% in 2009, although the result for 2010 will probably be significantly lower than initially expected and markedly below 5%. While in 2009 more than half of the sharp rise in the deficit was due to the automatic stabilisers and the decline in revenue from profit-related taxes (which had previously been extraordinarily high), the deterioration in 2010 is mainly attributable to fiscal policy measures. These are leading to substantial revenue shortfalls, as well as expenditure increases. Despite significantly above-trend growth in gross domestic product (GDP), the favourable cyclical influences could continue to be dampened as major macroeconomic reference variables for revenue (gross wages and salaries, private consumption) are increasing at a much weaker pace. After largely returning to normal levels in 2009, profit-related taxes could now see a stable development. The debt ratio, which had risen sharply to 73.1% in 2009, will continue to increase perceptibly.

Considerable deterioration in 2010, but more favourable than initially expected

As a result of the extensive tax cuts in 2010, the government revenue ratio is likely to decrease significantly. The greater tax deductibility of contributions to the health and long-

Tax cuts cause reduction in revenue ratio

* The analysis in the "General government budget" section is based on data contained in the national accounts and on the Maastricht ratios. Subsequent reporting on the 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.

term care insurance schemes and the various tax relief measures adopted in response to the crisis (most notably the lowering of income tax rates and corporate taxation relief measures) have thus produced considerable and, for the most part, permanent revenue shortfalls. By contrast, in the case of social security contributions, the financial effects of the various measures largely balance each other out. The fact that, unlike in 2009, major macroeconomic reference variables for revenue are developing less strongly than overall GDP is also having a dampening effect on the ratio.

Expenditure ratio could fall

Following a strong increase in 2009, the expenditure ratio could fall somewhat in 2010, despite marked growth in individual areas. Although government investment is being considerably increased as part of the fiscal stimulus packages, child benefit was raised again and spending on healthcare services will probably also continue to grow significantly, there will be an alleviating effect from the economic recovery (above all via higher GDP in the denominator), the discontinuation of both the car scrappage scheme and the child bonus, as well as proceeds from the frequency auction concluded in May being booked as reducing expenditure.¹

Improvement from 2011 onwards due to discontinuation of temporary measures, ...

In 2011, provided that spending policy is basically restrained, the general government deficit could decline to around 4% of GDP even without allowing for the more extensive consolidation measures adopted by the Federal Government in June. Although the one-off gains from insolvency benefit contributions, which are temporarily higher in 2010,

and the frequency auction will no longer have an effect, the cyclical influence could be slightly positive from today's perspective. Furthermore, various temporary economic stimulus measures will be discontinued. In particular, government investment is likely to decline following the expected increase in 2010.² However, the debt ratio is likely to rise further, primarily as a result of the deficit remaining high.

Although, as things currently stand, the general government deficit could be brought back below the 3% ceiling by as early as 2012, public finances will by then have deteriorated dramatically compared with the pre-crisis situation. The debt ratio will have risen sharply and central and state government budgets will still fall well short of the objective of bringing budgets close to balance in structural terms, which the reform of the national budgetary rules has made a constitutional requirement. The Federal Government's clear commitment to strengthening public finances and the consolidation measures adopted in June are therefore welcome. However, for the most part, the announcements still need to be clarified. Overall, the Federal Government is taking the path of a restrained and efficient use of funds, including reductions in staff levels, various increases

... but without additional consolidation, structural problems remain in medium term

¹ In the government's national accounts, the purchase and sale of non-financial assets are netted out and recorded on the expenditure side. Thus the auction proceeds reduce expenditure (as was the case with the proceeds from the sales of UMTS mobile telephone licences in 2000), whereas in the government's (budgetary) financial statistics they increase revenue.

² In the national accounts, investments are recorded in accordance with construction progress and are thus booked earlier than in the cash statistics (particularly those of the Investment and Repayment Fund).

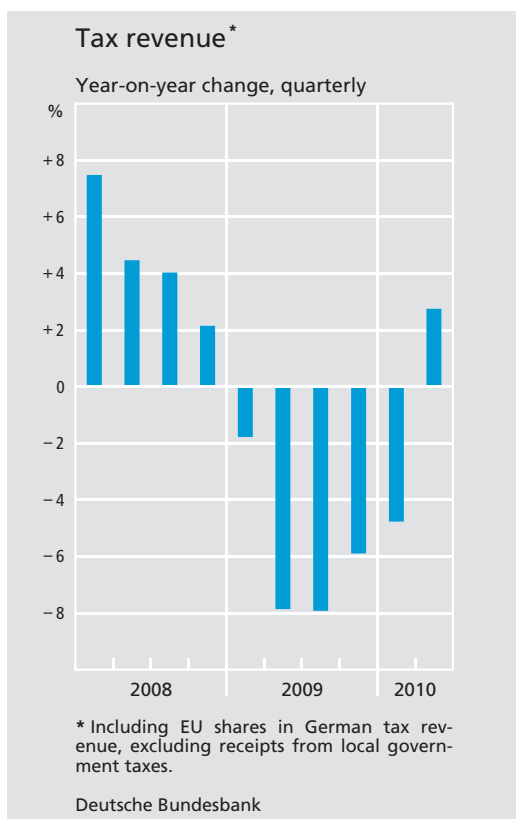
in taxes and social security contributions, as well as expenditure cuts in the field of transfer payments. Nonetheless, on the one hand, burdens are being shifted from the central government budget to the statutory pension insurance scheme and, on the other, the health insurance institutions are once more being given non-recurring grants to avoid them having to demand additional contributions or make savings on the expenditure side. No comprehensive review of tax subsidies and financial assistance has been carried out. However, from the autumn onwards, a commission is to look at turnover tax concessions. Given the more favourable than expected macroeconomic development, the temptation to dilute the fiscal policy stance (by means of tax cuts or increases in expenditure, for example) should be resisted and the deficit targets should be achieved sooner.

*Strengthen EU
rules*

The recent crisis has made it clear that sound public finances are also a key prerequisite for enabling fiscal policymakers to influence events in a crisis. Although the EU budgetary rules do, in principle, provide a suitable framework, they have been poorly implemented in the past. Furthermore, the no-bailout clause of the Treaty on the Functioning of the European Union, which is intended to maintain market-based incentives for sustainable national fiscal policies in monetary union, has been weakened by decisions to support individual euro-area countries. This points to the need to strengthen the EU budgetary rules and sharpen the instruments used to enforce them.³ There seems to be a general consensus that it is desirable to give greater weight to the debt level and, in par-

ticular, to the preventive arm of the Stability and Growth Pact, ie, among other things, correcting distortions at an early stage. There is also a wish to improve the coordination of budgetary surveillance and recommendations at EU level with the national budgetary plans. Furthermore, there are plans to improve the monitoring of economic imbalances in individual euro-area countries. Given the macroeconomic distortions that have become evident in some euro-area countries, this is necessary, but the effectiveness of relevant political control mechanisms should not be overestimated. Overall, it is particularly important to increase the incentives for adhering to the provisions for public finances, *inter alia*, by appropriate sanctioning of non-compliance. However, as fiscal policy will ultimately remain under national jurisdiction, it appears necessary to improve the anchoring of regulations aimed at sustainable public finances at this level too. Furthermore, limiting the moral hazard stemming, in particular, from institutionalised crisis resolution mechanisms at European level is likely to be crucial. Without the political will to comply with the jointly agreed fiscal policy framework in monetary union, however, all efforts at reform will ultimately come to nothing. An important test will be whether compliance with the agreements within the framework of the ongoing excessive deficit procedure is rigorous. However, in its assessment of the development of public finances and the corrective action taken in some countries, the Ecofin Council has not always pushed for a rigorous implementation of the provisions.

³ See also Deutsche Bundesbank, Fiscal developments in the euro area, Monthly Report, May 2010, p 27.



Budgetary development of central, state and local government

Tax revenue

Marked rise in tax revenue in Q2

In the second quarter, tax revenue⁴ was up by 3% on the year (see above chart and table on page 65). In addition to the underlying dynamics once again being more favourable, the fact that the same quarter in 2009 was affected by particular burdens (including the one-off child bonus) is also of significance here. Overall, this more than compensated for the shortfalls arising from legislative changes – in particular, the greater tax deductibility of contributions to the health and long-term care insurance schemes, the second stage of the reduction in the income

tax rates, corporate taxation relief measures and the increase in child benefit.⁵

Revenue from income-related taxes rose by 6% in total. Wage tax receipts were at about the same level as a year earlier, with the positive impact of wage developments and the overall negative effect of legislative changes offsetting each other. Profit-related taxes recorded strong growth overall (+17½%). There was a stable underlying trend in the receipts from assessed income tax, while deductions (refunds made to employees and grants to investors and homebuyers) fell. Corporation tax revenue increased strongly from the very low level recorded one year previously. In contrast to the assessed taxes, investment income tax continued to post considerable shortfalls. Receipts from consumption-related taxes rose slightly (+½%). This modest increase is consistent with the subdued development of private consumption.

Substantial increase in income-related taxes

Only slight rise in consumption-related taxes

According to the latest official tax estimate in May, a decline of 2½% (including local government taxes) is expected for 2010 as a whole. Although tax revenue fell by only 1% in the first half of the year, various factors accounting for this should be noted. For example, the relief provided by the discontinuation of the grant to homebuyers (which is deducted from the revenue total) was mainly felt in March. Furthermore, the base figures in the first two quarters of 2009 were particu-

Decline in revenue in 2010 as a whole could be somewhat smaller than expected

⁴ Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the last quarter recorded.

⁵ Unlike in the national accounts, in the government's financial statistics, child benefit payments are not recorded on the expenditure side, but are deducted from wage tax receipts.

Tax revenue

Type of tax	H1				Q2				Estimate for 2010 1,2
	2009		2010		2009		2010		
	€ billion		Year-on-year change € billion	as %	€ billion		Year-on-year change € billion	as %	Year-on-year percentage change
Tax revenue, total 2	237.3	235.0	- 2.3	- 0.9	120.5	123.9	+ 3.3	+ 2.8	- 2.6
<i>of which</i>									
Wage tax	64.5	60.7	- 3.8	- 5.8	30.5	30.4	- 0.0	- 0.1	- 7.4
Profit-related taxes 3	34.0	36.1	+ 2.0	+ 6.0	18.0	21.2	+ 3.2	+ 17.7	- 6.7
Assessed income tax	12.1	15.8	+ 3.7	+ 30.8	9.1	9.7	+ 0.5	+ 5.9	+ 0.1
Corporation tax	4.7	5.8	+ 1.0	+ 21.9	0.3	3.8	+ 3.5	.	- 2.1
Investment income tax 4	17.2	14.5	- 2.7	- 15.8	8.5	7.7	- 0.8	- 9.7	- 15.2
Turnover taxes 5	86.5	87.2	+ 0.7	+ 0.8	43.4	44.3	+ 0.9	+ 2.1	+ 1.6
Energy tax	14.8	14.0	- 0.8	- 5.4	10.1	9.6	- 0.5	- 4.6	- 1.6
Tobacco tax	5.9	5.8	- 0.1	- 2.3	3.6	3.3	- 0.2	- 6.5	- 1.2

1 According to official tax estimate of May 2010. — 2 Including EU shares in German tax revenue, excluding receipts from local government taxes. — 3 Employee refunds, grants paid to homebuyers 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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larly low as the child bonus payments, as well as a large part of the tax refunds in connection with the ruling on the standard travel allowance for commuters, were booked during this period. However, amid all the uncertainty, there are indications that the expectations of the tax estimate could be exceeded.

Central government budget

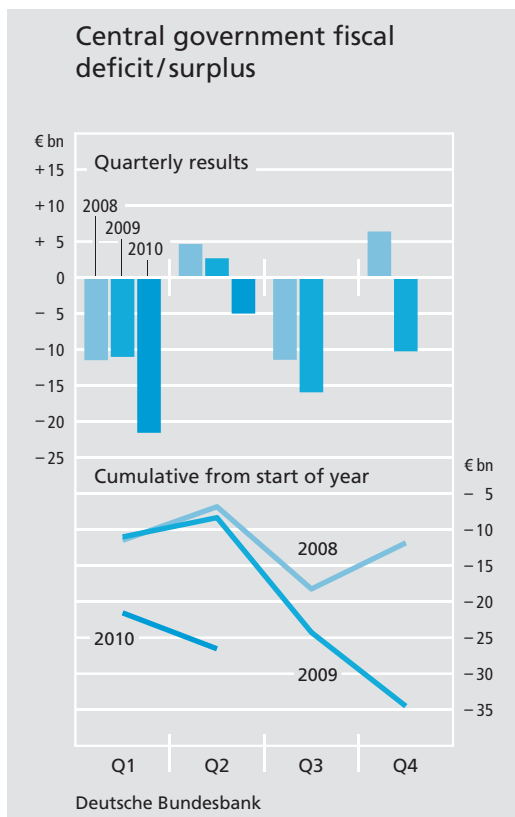
The central government budget recorded a deficit of €5 billion in the second quarter of 2010, compared with a surplus of just over €2½ billion one year earlier. Revenue rose by 6% (€4½ billion) on balance due to inflows from the frequency auction. However, at 17½% (€12 billion), spending growth continued to far outweigh the increase in revenue. At €7 billion, grants to the social insur-

ance schemes made the largest contribution to this expansion in expenditure. The Federal Employment Agency alone received €3½ billion in additional funds. Furthermore, it was, above all, the payments to the health insurance fund that were increased sharply – to offset the cut in the contribution rate from July 2009 onwards, but also as a result of a regular rise and the special grant to offset crisis-induced contribution shortfalls.

When drafting its budget for 2011, central government presented a significantly more favourable estimate for 2010 as a whole than had been used as a basis at the adjustment meeting in March. At €65 billion, net borrowing is expected to be €15 billion lower than planned. The main reasons for the improvement are additional revenue pursuant to the

Marked deterioration in budget balance in Q2

However, deficit for 2010 as a whole considerably lower than forecast



May tax estimate and from the frequency auction (€4½ billion in each case), as well as cost savings of €6 billion, particularly in the area of labour market-related expenses (expenditure to offset the Federal Employment Agency's deficit and benefits for the long-term unemployed), and in the areas of interest costs and calls on guarantees. The central government budget's structural deficit (which is relevant in the context of the new debt rule) is expected to amount to €53 billion. Expenditure on acquisitions and revenue from the realisation of financial assets, which are to be excluded from the calculation of the structural deficit, more or less balance each other out, and the cyclically induced budgetary burdens are estimated at €12 billion. From today's perspective, net borrowing could be approximately €5 billion lower than

forecast and the structural value could also be considerably more favourable. Owing, in particular, to the continued positive developments on the labour market, there are signs of a further easing of budgetary burdens and of considerable additional relief, above all with regard to interest expenditure. After deducting the transfers to the EU budget, the remaining tax revenue also appears to be higher than expected.

When drawing up its budget for 2011, central government had to comply with the provisions of the new debt rule for the first time. The rule states that the structural deficit in the base year 2010 must be reduced in equal annual steps to a maximum of 0.35% of GDP by 2016. Central government is taking the updated forecast for 2010, rather than the very cautiously estimated budget target, as a basis. This is to be welcomed, as it demonstrates central government's commitment to the intention of the debt brake. However, compliance with the provisions is not yet guaranteed, as a sizeable chunk of the total budgetary relief of €11 billion is based on Federal Cabinet decisions that have yet to be adequately defined. Thus, additional tax revenue of €5 billion is forecast on the basis of plans in connection with a nuclear fuel elements tax, an ecological aviation tax, the abolition of the "free-rider" effects with regard to energy tax benefits, and awarding privilege to state creditors in insolvency cases, even though the relevant draft laws have not yet been passed. Furthermore, the bulk of the agreed savings of €2½ in the area of administration included in the draft budget were merely global cuts in expenditure. Although

Clear commitment to new borrowing limit in draft budget for 2011, ...

... but clarification still required

the planned discontinuation of pension contributions for recipients of unemployment benefit II will ease the strain on the central government budget by €2 billion, it will place an equal-sized burden on the pension insurance scheme and will thus initially make no contribution to reducing the general government deficit, which is also necessary. Central government's structural deficit will be influenced by a few special transactions. Thus, from 2011 onwards, the Federal Employment Agency will only receive loans to balance its budget. As they are classified as financial transactions, these loans are not relevant to the new borrowing limit, whereas the 2010 grant to the Federal Employment Agency will increase central government's structural deficit by around €5 billion on a one-off basis.⁶ However, in 2010 this will be compensated for by a windfall of around the same amount from the frequency auction.⁷

Despite substantial budgetary risks, borrowing limit largely exhausted

Overall, at €46 billion (with net borrowing of €57½ billion), the level of the structural deficit recorded in the draft budget is €7½ billion lower than in central government's revised estimate for 2010. However, this means that the borrowing limit is undershot by only €0.015 billion. Even individual items that were cautiously estimated in the draft budget for 2011, such as, in particular, interest expenditure and possibly tax revenue, are ultimately likely to form hardly any buffer here, as the foreseeable further improvement in financial developments in 2010 by the time the budget is planned to be passed (November) would have to taken into account when calculating the borrowing limit up to 2016. Such reduced scope for new borrowing from

2011 onwards could even make further consolidation measures necessary. Moreover, if the extensive, but in some cases controversial, consolidation plans cannot be fully implemented through the parliamentary process, there would be a need to find a suitable alternative within a relatively short space of time. An adequate safety margin with respect to the borrowing limit is also fundamentally necessary in light of the high degree of uncertainty regarding economic and budgetary developments. Without such a margin, there is a risk that possible revisions will make it necessary to introduce consolidation measures at short notice.

The financial plan up to 2014 shows the additional adjustment steps required owing to the new borrowing limit. Provided that the negative cyclical influence on the central government budget has completely disappeared by the final year (2016) and that from 2013 onwards there are slight surpluses from the realisation of financial assets as a result of assumed loan repayments from the Federal Employment Agency, the plan foresees a

Financial plan up to 2014 in line with debt brake but austerity measures still need to be clearly defined

⁶ There is a danger that, across the economic cycle, the Federal Employment Agency's funds may not actually be sufficient to repay the loans, as is currently hoped will be the case. If the option of waiving central government claims is then considered, it is paramount that this be taken into account when calculating the debt brake, so that the latter is not circumvented.

⁷ The decline in the structural deficit is also amplified as a result of a change in the way it is calculated. Thus, in the 2011 budget plan, profit distributions of €½ billion are no longer recorded as privatisation proceeds, ie financial transactions that do not influence the structural deficit. Although, in principle, this is justified, as they represent current income from business activities, the fact that the change is not being introduced this year but in 2011 – the launch year for the new borrowing limit – should be viewed critically. Consequently, the level recorded for the 2010 structural deficit, and thus also for the scope for borrowing and the reduction in the structural deficit in 2011, will be artificially high.

Medium-term financial plan and permissible net borrowing of central government under the debt rule

€ billion

	Actual result 2009	Target 2010	Expected actual result 2010 ¹	Draft 2011	Financial plan		
					2012	2013	2014
Expenditure ²	292.3	319.5	–	307.4	301.0	301.5	301.1
<i>of which</i>							
Investment ³	27.1	28.3	–	27.3	26.9	26.4	26.0
Revenue ^{2, 4}	258.0	239.3	–	249.9	260.9	269.9	277.0
<i>of which</i>							
Tax revenue ²	227.8	211.9	–	221.8	232.8	241.8	250.3
Revenue from capital assets (including privatisations)	2.2	2.3	–	2.6	3.3	3.3	0.2
Net borrowing	34.1	80.2	65.2	57.5	40.1	31.6	24.1
<i>Memo item</i>							
Structural net borrowing (from 2011 onwards: upper limit)	–	66.6	53.2	45.8	39.0	32.1	25.1
as a percentage of GDP ⁵	–	2.8	2.2	1.9	1.6	1.3	1.0
Less cyclical component	–	– 13.6	– 12.0	– 5.5	– 3.3	– 1.3	0.4
Less balance of financial transactions	–	0.0	0.0	– 6.2	– 0.9	1.8	0.6
Net borrowing (from 2011 onwards: upper limit)	–	80.2	65.2	57.5	43.1	31.6	24.1
Percentage increase in expenditure	+ 3.5	+ 9.3	–	– 3.8	– 2.1	+ 0.2	– 0.1

¹ Estimated by central government on the basis of the current budget implementation (date: June 2010). Used when drafting the central government budget to determine the starting structural deficit value for the mandatory path to reduce the deficit within the framework of the new debt rule. — ² After deducting supplementary central government grants, shares in energy tax

revenue, compensation as part of the 2009 motor vehicle tax reform and consolidation assistance from 2011 onwards, which are all remitted to state government. — ³ Excluding loans to the Federal Employment Agency. — ⁴ Including proceeds from coin seigniorage. — ⁵ Nominal GDP in the year preceding the drafting of the budget (date: spring forecast 2010).

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steady reduction in the structural deficit to €25 billion. The austerity measures, which have yet to be clearly defined, have been included in this calculation. Furthermore, there is a remaining gap of €5 billion in 2014, which is only covered by global cuts in expenditure. With the exception of 2012, the permissible limit for the structural deficit is exhausted throughout virtually the entire planning period. Thus, as is the case for the 2011 draft budget, there is no safety margin with respect to the borrowing limit, as would be advisable given the high degree of estimation uncertainty.⁸ With regard to central government's future savings potential, it should be noted that, following the conversion of the grant to the Federal Employment Agency to offset its deficit into a loan, labour market-

related savings can only be included if they fall under central government's core budget.⁹

At around €3 billion, the deficit recorded by the central government's off-budget entities in the second quarter was significantly lower than in the same period one year previously (€14 billion). This was ultimately

Off-budget entities record lower deficit in Q2

⁸ See also Deutsche Bundesbank, The reform of the borrowing limits for central and state government, Monthly Report, May 2009, pp 78-79 and J Kremer and D Stegarescu (2009), Neue Schuldenregeln: Sicherheitsabstand für eine stetige Finanzpolitik, Wirtschaftsdienst, Vol 89/9, pp 630 ff (in German only).

⁹ Thus, for example, although the Federal Employment Agency's savings with regard to active labour market policy measures, which are included in the list of austerity measures from June, reduce its loan requirements or increase the scope for it to make loan repayments to central government, they have no influence on central government's structural budgetary situation in terms of the debt rule. By contrast, any revenue shortfalls resulting from induced lower reintegration payments from the Federal Employment Agency, are to be viewed as placing a burden on the (core) budget.

due mainly to the fact that the extensive capital injections that SoFFin had made to credit institutions during the same period of 2009 were no longer a factor. With lower levels of capital injections, SoFFin's deficit amounted to €2 billion in the second quarter. After already recording a deficit of €1 billion in the same period of 2009, predominantly as a result of the car scrappage scheme, the Investment and Repayment Fund once again recorded a deficit of €1 billion, owing mainly to payments made for state and local government investment projects. However, it is now expected that a large proportion of the investment funds will not be paid out until some time in 2011. Excluding further burdens arising from support given to credit institutions, the off-budget entities are expected to record a deficit of around €10 billion in 2010, compared with more than €20 billion in 2009.

State government¹⁰

In the second quarter of 2010, state government recorded a decline in its deficit from €2½ billion one year previously to €½ billion. A prominent contributory factor was the rise in receipts (of 4% or €2½ billion). Despite revenue shortfalls due to the transfer of receipts from motor vehicle tax to central government – for which, in return, compensation of €2¼ billion per quarter is paid – tax revenue fell only slightly overall (-½%). At the same time, expenditure went up by just over 1% (€1 billion). Personnel expenses continued to rise (+2¼%), not least as a result of the second stage of the wage adjustment agreed in 2009 and the associated pay increases.

Despite this somewhat more favourable development and the fact that the budget is not burdened with extensive bank recapitalisations as it was in 2009, a very high deficit of around the same size as in 2009 (€25 billion) is expected for 2010 as a whole. A drop in tax receipts due to tax cuts, higher expenditure on staff and other operating expenses and state government's participation in investments as part of the second fiscal stimulus package, which are gaining momentum, largely account for this. At present, the budget plans even forecast an increase in the deficit to just under €33½ billion. Only Bavaria, Mecklenburg-West Pomerania and Saxony do not intend to take on additional debts. All other federal states are planning to increase their net borrowing (which was already very high in 2009) – in some cases, considerably.

In May this year, Schleswig-Holstein was the first federal state to bring the borrowing limit in its state government constitution in line with the new debt brake pursuant to Article 109 of the German Basic Law (*Grundgesetz*), thereby also enshrining the conditions for receiving consolidation assistance during the transitional period in its constitution.¹¹ Irrespective of the fundamentally

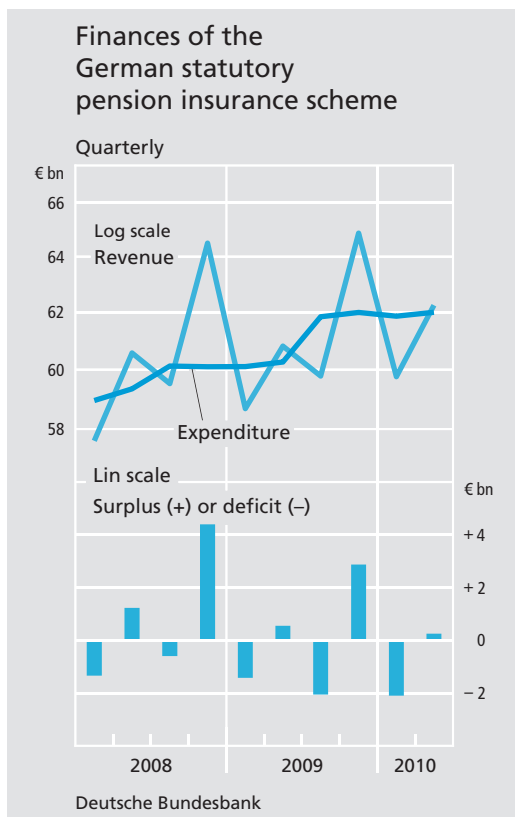
... nevertheless, very high deficit, as in 2009, expected for 2010 as a whole

Schleswig-Holstein implements new debt rule

Lower deficit in Q2, ...

¹⁰ 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. These are the most recent data available.

¹¹ However, at the same time, the state parliament of Schleswig-Holstein reiterated the position stated in the case it had filed with the Federal Constitutional Court opposing the state government debt brake in the German constitution (Basic Law). This case opposes the restriction of the state of Schleswig-Holstein's budgetary autonomy through central government legislation. Nonetheless, if this case is successful and the provision requiring the federal states to achieve a structurally balanced budget is reversed, the basis for consolidation assistance would be called into question.



stricter provision requiring the federal states to achieve a fully structurally balanced budget, the new regulation is, in part, even more restrictive than at central government level. At the same time, a relatively comprehensive austerity package to gradually reduce the high structural deficit was drawn up. The other federal states have yet to implement the new debt rules in this way. Particularly given the limited fiscal leeway in individual federal states, measures to achieve the prescribed structurally balanced budget by 2020 will have to fall mainly on the expenditure side. In light of this, the fact that the federal state of North Rhine-Westphalia, which has the largest population, has even announced that it will significantly raise its already considerable net borrowing in 2010 by means of discretionary measures is a cause for concern.

The transitional assistance for the five particularly highly indebted federal states is to be paid from as early as 2011, while the 2010 structural deficit will form the starting value for the consolidation that is required in return. To aid the further budgetary and medium-term financial planning of the recipient federal states and ensure the concrete implementation of measures, it is therefore important that the relevant administrative agreements are concluded as soon as possible. Some important issues are still outstanding in this respect. In particular, it still needs to be decided how the structural budgetary balance (especially the cyclical component) should be calculated. It would appear desirable to agree on a uniform procedure for all the federal states, in order to promote transparency and ensure comparable results.

Social security funds¹²

Statutory pension insurance scheme

At €½ billion, the statutory pension insurance scheme's surplus in the second quarter of 2010 was virtually unchanged on the year. Growth in revenue (+2½%) was only slightly slower than that in expenditure (+3%). At just over 2%, employees' compulsory contributions increased significantly more sharply than in previous quarters. The favourable labour market and pay developments evident

Surplus only slightly lower in Q2

¹² The financial development of the statutory health and public long-term care insurance schemes in the first quarter of 2010 was analysed in the short articles of the Monthly Reports of June and July. These are the most recent data available.

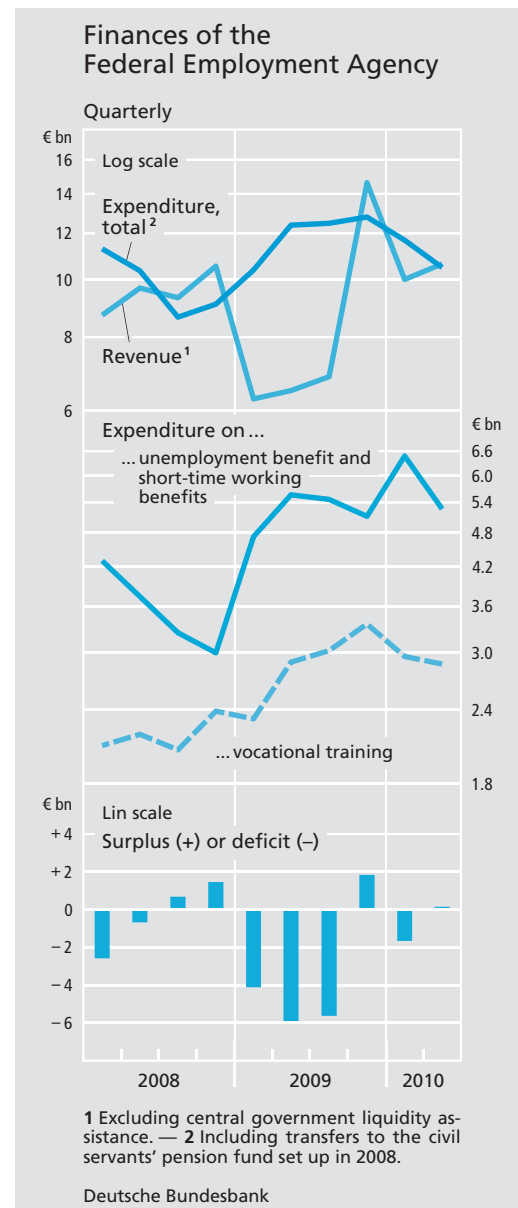
here are also reflected in the fact that, for the first time since the start of 2009, contributions for recipients of unemployment benefits were no longer up on the year. The expenditure developments are mainly attributable to the high pension increase in mid-2009. There was still only a marginal expansion in the number of pensions.

Balanced financial result for 2010 as a whole appears possible

A perceptible financial improvement is expected in the second half of 2010. One reason for this is that there was no pension increase on 1 July.¹³ Furthermore, contribution receipts will increase further and, particularly in the final quarter, a clear surplus is expected. Therefore, it now appears entirely possible that the statutory pension insurance scheme will end the year without a deficit.

Financial burden due to austerity package

As part of its austerity package, central government plans to stop paying pension contributions on behalf of recipients of unemployment benefit II from 2011 onwards. As a result, the pension insurance scheme will see a direct loss in revenue of just under €2 billion and it will ultimately be necessary to put up contributions sooner. However, in the long-term, pension claims will thus also be lower. This may then lead, in cases of individual need, to claims for the basic allowance being made or being higher in old age. Nonetheless, the new regulation means that means-tested transfer payments will be made in a more targeted manner overall, as contribution payments will no longer be made on behalf of those recipients of unemployment benefit II who will no longer need assistance when they reach retirement age. This will help to ease the burden on public finances,



which face major challenges in the light of demographic change.

¹³ However, without the extended pension guarantee, the drop in average remuneration in 2009 would have resulted in pensions being cut by around ½% in western Germany.

Federal Employment Agency

Financial improvement in Q2

In the second quarter of 2010, the Federal Employment Agency recorded a slight surplus, compared with a deficit of €6 billion one year previously. This marked improvement is, of course, largely due to the fact that the burden on the Federal Employment Agency was considerably eased in the first half of the year by central government grants being brought forward and reintegration payment instalments, which the Federal Employment Agency has to transfer to central government, being deferred until the second half of the year. Without these special effects, the Federal Employment Agency would have recorded a deficit of around €4½ billion.

Strong revenue growth due to Federal Employment Agency contributions and insolvency benefit contributions ...

However, even after adjustment for the central government funds that were brought forward, revenue still went up by 11%. Although the marked increase of 3½% in contribution receipts was also a contributory factor, growth in revenue resulting from the sharp rise in insolvency benefit contributions played a more significant role.¹⁴ After adjustment for the deferred reintegration payments, the Federal Employment Agency's expenditure was down by just over 4% on the year. While only slightly less was spent on unemployment benefit I and active labour market policy measures, there was, in particular, a significant decline in expenditure on short-time working benefits.

... alongside drop in expenditure on short-time working benefits

Over the remainder of the year, the reintegration payments will be due and the regular central government grants, which were brought forward, will not appear on the revenue side. The Federal Employment Agency can therefore be expected to record a significant deficit, which this year, on an exceptional basis, will not be offset by a loan but by a grant from central government. However, the required grant is likely to be considerably lower than the almost €13 billion that was forecast in the central government budget plan passed in March. The Federal Employment Agency recently estimated that it would require a grant of €8½ billion.

Grant required for 2010 considerably lower than forecast

In 2011, the contribution rate to the Federal Employment Agency will be raised from 2.8% to 3.0%. However, the level of receipts achieved in this way will only suffice over the economic cycles if expenditure – particularly on active labour market policy measures – is drastically reduced on a permanent basis, as announced, in principle, by the Federal Government. Otherwise, the Federal Employment Agency will not be able to repay future central government loans in full.

Size of 2011 contribution rate increase only sufficient if there is a sharp cut in expenditure

¹⁴ As expenditure on insolvency benefit payments substantially exceeded contribution receipts in 2009, the contribution rate was raised at the start of 2010 from 0.1% to 0.41%. In accordance with the legal requirements, this should thus offset the 2009 deficit and cover expenditure in 2010. Owing to expenditure on insolvency benefit payments being lower than expected, the resulting surplus should be more than enough to offset the 2009 deficit.