Public finances*

General government budget

General government budget still broadly balanced in 2013

General government looks set to record another broadly balanced budget in 2013,[1] after posting a small surplus of 0.1% of gross domestic product (GDP) in 2012. The macroeconomic slowdown in 2013 will probably only be reflected to a limited extent in the general government budget figures as a result of stable developments in key macroeconomic reference variables (gross wages, unemployment, private consumption). There will probably also be hardly any change in the fiscal balance after adjustment for cyclical effects. Although fiscal policy measures – notably the significant cut in the pension contribution rate and the abolition of the surgery visit charge – will produce budgetary burdens on balance, interest expenditure is likely to provide further relief and additional revenue from fiscal drag[2] is expected.

Debt ratio declining

The debt ratio is likely to decline perceptibly (end of 2012: 81.9%). This is due, first, to a further portfolio reduction among the government-owned "bad banks", which is lowering government debt. Second, the increase in nominal GDP in the denominator is reducing the debt ratio. These two factors more than offset the ratio-raising effect of the ongoing deficits in many government budgets and the euro-area stabilisation measures. At the end of the first quarter of 2013, the debt ratio stood at 81.2%.

2014: slight budgetary improvement if policy stance unchanged

Economic activity is currently expected to have hardly any impact on the state and development of the general government budget in 2014. Overall, however, general government finances are likely to continue to benefit from favourable conditions, characterised by low unemployment figures and interest rates as well as a relatively revenue-rich GDP structure. The fiscal policy stance currently mapped out in the budget plans envisages only limited new budgetary burdens (on balance). Under these circumstances, the fiscal balance would improve slightly – not least because of a further decline in interest expenditure – and the debt ratio would continue to fall.

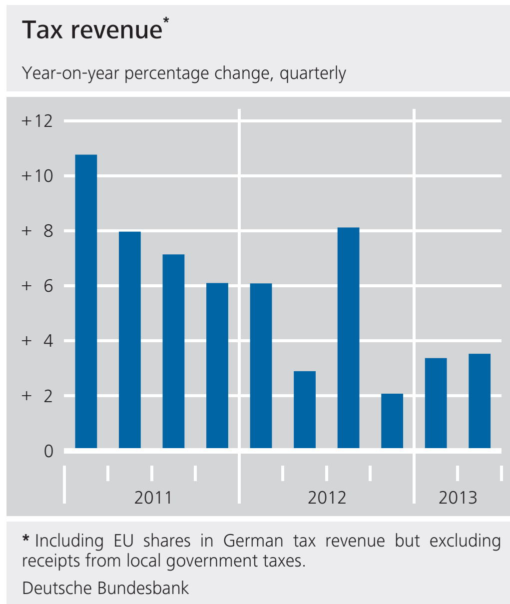
Goal: moderate structural surpluses

According to central government's current projections, general government is set to record consistent structural surpluses of ½% of GDP. Even under this assumption, which would be an exceptionally favourable outcome by historical standards, central government expects the debt ratio to stand at nearly 70% in 2017. This includes the effects of support measures for German financial institutions and euro-area countries. So far, only a small proportion of the various measures have been recorded as transfers affecting the deficit; in most cases, the financial assets acquired at the same time (eg credit claims) were recorded in addition to the associated liabilities. Nonetheless, these assets carry considerable risks.

Marked surpluses advisable given challenges

The budgetary stance envisaged at present is more or less neutral and complies with European rules. Since the level of debt is still high and the underlying conditions for public finances are very favourable, it would be advisable to rapidly achieve significant structural surpluses. It would also be sensible to include such surpluses in the budget plans to ensure that central and state government achieve sizeable safety margins vis-à-vis the respective national deficit ceilings, which can then be used in case of need. Another factor to be con-

* The analysis in the "General government budget" section is based on data contained in the national accounts and on the Maastricht ratios. The subsequent reporting on the budgets of the various levels of government and the social security funds is based on the figures as defined in the government's financial statistics (which are generally in line with the budget accounts).
1 The following analysis is based on the assumption that the euro-area debt crisis will not escalate again.
2 In this context, the term "fiscal drag" encompasses the (positive) revenue effect of bracket creep in income taxation and the (negative) impact of the fact that specific excise duties are largely independent of prices.



* Including EU shares in German tax revenue but excluding receipts from local government taxes.
Deutsche Bundesbank

sidered is that demographic change will result in greater burdens for government budgets from around the middle of this decade. Decision-makers should therefore use the current "demographic lull" – during which the elderly dependency ratio has temporarily stabilised – as an opportunity for resolute action to significantly reduce the debt ratio and thus lower the interest burden on a permanent basis. The success of this undertaking will ultimately hinge on ensuring that surpluses are not just projected in budget plans but actually achieved in practice. Sound public finances and policies shaping the country's future are not contradictory aims; they must complement one another.

Budgetary development of central, state and local government

Tax revenue

Robust tax revenue growth in Q2

Tax revenue[3] was up by 3½% on the year in the second quarter (see chart above and the table on page 69). Revenue from income-related taxes rose by 7½%, thereby mirroring growth in wage tax. The latter is largely attributable to the positive developments in gross wages and salaries. However, the effects of tax bracket creep and stagnant deduction amounts (subsidies for supplementary private pension plans and child benefit) also played a role. Revenue from profit-related taxes likewise recorded strong growth (8%) and so far the macroeconomic slowdown has hardly had any impact on this figure either. The somewhat sharper rise in assessed taxes is primarily attributable to weaker growth in income tax refunds to employees. Revenue from consumption-related taxes went up by only just over ½%. Although receipts from turnover tax increased at a significantly weaker pace than their macroeconomic reference variables, there are often large intra-year fluctuations in turnover tax revenue.[4]

Robust growth for year as a whole too

According to the official tax estimate in May, tax receipts for 2013 as a whole are expected to rise by 2½% (including local government taxes). This growth chiefly reflects the assumption that macroeconomic developments will be subdued yet still provide a relatively favourable structure for public finances. Furthermore, fiscal drag is expected to generate additional revenue on balance, while legislative changes are not likely to have any notable net impact. However, various special factors are slowing growth in revenue.[5] Overall, receipts developed somewhat more favourably in the first half of the year than originally assumed. Nonetheless, there is generally a great deal of uncertainty surrounding the sometimes sharp fluctuations in revenue from profit-related taxes, which has been high to date. Furthermore, turnover tax revenue, which has been weak so far, has been very volatile in recent months.

3 Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the quarter under review.
4 Fluctuations in revenue may stem in particular from the sometimes large refunds or supplementary payments that are due when advance payments made during the course of the year deviate from the final amount of tax payable.
5 Above all, tax refunds due under the ruling by the European Court of Justice on the taxation of dividends paid to EU/EEA companies (ruling of 20 October 2011 on case C-284/09).

Tax revenue

Type of tax	H1 2012 € billion	H1 2013 € billion	H1 2013 Year-on-year change € billion	H1 2013 Year-on-year change as %	Estimate for 2013[1,2] Year-on-year change as %	Q2 2012 € billion	Q2 2013 € billion	Q2 2013 Year-on-year change € billion	Q2 2013 Year-on-year change as %
Tax revenue, total[2]	268.2	277.5	+ 9.3	+ 3.5	+ 2.5	137.6	142.5	+ 4.9	+ 3.5
of which									
Wage tax	70.3	75.3	+ 5.0	+ 7.2	+ 5.4	36.1	38.8	+ 2.7	+ 7.4
Profit-related taxes[3]	46.1	49.0	+ 2.8	+ 6.2	+ 1.2	23.7	25.6	+ 1.9	+ 8.2
Assessed income tax	18.5	21.8	+ 3.4	+ 18.2	+ 8.4	10.0	11.1	+ 1.1	+ 10.7
Corporation tax	10.5	11.4	+ 1.0	+ 9.3	+ 11.4	5.0	5.4	+ 0.4	+ 8.7
Investment income tax[4]	17.2	15.7	− 1.5	− 8.7	− 14.5	8.7	9.1	+ 0.4	+ 5.0
Turnover taxes[5]	95.6	96.3	+ 0.7	+ 0.8	+ 1.8	46.6	47.1	+ 0.5	+ 1.1
Energy tax	14.1	14.1	+ 0.0	+ 0.2	+ 0.5	9.7	9.5	− 0.2	− 2.4
Tobacco tax	5.9	5.6	− 0.2	− 3.6	− 1.4	3.5	3.5	− 0.0	− 1.3

1 According to official tax estimate of May 2013. **2** Including EU shares in German tax revenue but excluding receipts from local government taxes. **3** Employee refunds, homebuyers' grant and investment grant deducted from revenue. **4** Withholding tax on interest income and capital gains, non-assessed taxes on earnings. **5** Turnover tax and import turnover tax.
Deutsche Bundesbank

Central government budget

Sharp drop in surplus in Q2 due to ESM financing

The central government budget recorded a surplus of €1 billion in the second quarter, which was €5 billion lower than at the same time last year. Revenue rose by only ½% (€½ billion). Tax revenue stagnated, not least because deductions for transfers to the EU budget increased by €1½ billion. By contrast, expenditure rose sharply (by 7½%, or €5½ billion). Transfers to the social security funds were €1½ billion lower owing to the abolition of the turnover-tax-financed grant to the Federal Employment Agency and the cut in payments to the health insurance fund. However, above all the €4½ billion capital injections into the European Stability Mechanism (ESM) placed a strain on the budget. Furthermore, the payments made to state government were €1 billion higher, not least because of central government's increased contribution to the basic allowance for the elderly. In addition, spending on personnel and other operating expenditure were both up by €½ billion on the year.

Supplementary budget to finance €8 billion allotment for flood assistance fund

Central and state government have agreed to establish an €8 billion assistance fund to repair the severe damage caused by floods in some regions of Germany in the spring. The fund will be financed upfront by an advance payment from central government in 2013. To this end, a supplementary budget was approved at short notice, raising the permissible level of net borrowing by €8 billion to €25.1 billion. The supplementary budget did not contain any further amendments, even though some major deviations vis-à-vis the 2013 budget have occurred or come onto the horizon since the budget was approved in autumn 2012. For example, the Bundesbank's profit distribution in March 2013 was €1 billion lower than projected, in the May tax estimate the revenue forecast for central government was revised downwards by €2 billion, and additional assistance for Greece was agreed at the end of November 2012.

Recent decisions of the Ecofin Council regarding the excessive deficit procedures for euro-area countries

At its meeting on 21 June 2013, the Economic and Financial Affairs Council of the European Union (Ecofin) adopted a number of decisions regarding the excessive deficit procedure (EDP). Twelve of the 17 euro-area member states are still subject to an EDP. The Council closed its procedure against Italy after it managed to reduce its deficit ratio below the 3% ceiling last year and both Ecofin and the European Commission expect that it will keep its deficit below this benchmark in the coming years. An EDP was, however, reopened for Malta – just a few months after the old procedure had been closed – after it exceeded the reference value for 2012.

Belgium was the only country where the procedure was stepped up, ie the Council gave notice to take measures,[1] with 2013 being set as the new deadline for correcting the excessive deficit. Belgium failed to meet the 3% deficit limit in 2012 within the set deadline without an invocable excuse for this under the terms of the EDP. The Commission did, however, refrain from making a recommendation to the Council to impose a fine on Belgium, even though this is the measure envisaged following the amendment of the Stability and Growth Pact in 2011.

Six other euro-area countries (Cyprus, France, the Netherlands, Portugal, Slovenia and Spain) which also failed, or are expected to fail, to achieve the correction by the set deadline were excused under the terms of the EDP. Their respective correction deadlines were extended by one or more years without this resulting in a stepping-up of their EDP. These decisions were based on analyses carried out by the Commission to ascertain whether previous recommendations made under the EDP have been observed by the member states in question.

The European fiscal rules allow deadline extensions without stepping up the EDP provided that two conditions are met: first, effective action must have been taken to correct the excessive deficit by the set deadline and, second, unexpected adverse economic events must have occurred with major unfavourable consequences for government finances.

In order to assess whether effective action has been taken, the Commission considers whether the measured structural improvement meets, as a minimum, the requirements specified in the recommendation. This now includes taking special factors into account, which involves examining to what extent the Commission's assessment of potential growth and revenue elasticities has changed since it issued its initial recommendation. The associated impact on the structural balances is factored out of the calculation. This adjustment has the effect, for example, that lower structural revenues than expected by the European Commission, which do not result from legislative changes, are disregarded almost automatically. In a further step, the individual consolidation measures taken are considered in assessing the structural improvement (bottom-up approach).

1 If the Council decides in accordance with Article 126 (8) of the Treaty on the Functioning of the European Union (TFEU) that no effective action has been taken, it shall decide within two months to give notice to the member state to take measures to reduce the deficit. Pursuant to Article 126 (9) TFEU, it sets out measures conducive to achieving the deficit targets. A new reform package (Two Pack regulations) which entered into force in May 2013 foresees a more comprehensive reporting requirement than in the previous procedural step (Article 126 (7) TFEU) and also quarterly, instead of bi-annual, reviews. If a member state fails to comply with a decision taken in accordance with Article 126 (9) TFEU, the Council may impose sanctions (Article 126 (11) TFEU).

On the one hand, the intent underlying this approach is understandable – that is, not to blame the member state for unexpected (negative) shocks to the deficit ratio, provided that these were not brought about by the member state itself. On the other hand, this approach conflicts with the aim of the fiscal rules, which is to prevent unsound budgetary developments. In critical situations, in particular, it is the objective results and fiscal sustainability that are paramount, and not so much the subjective responsibility of the government in question. This is all the more important given that the requirements are often formulated as minimum targets, which implies a responsibility on the part of governments to ensure sufficient safety margins. Bearing that in mind, it is worrying that this approach continues the tendency towards reducing the significance of straightforward and comprehensible criteria for the decision-making process. Moreover, the increasing complexity of the rules gives the Commission and the Council considerable discretionary latitude. This arbitrary leeway encourages greater political bargaining and is likely to lead governments to expect a "generous" interpretation, especially where precedents exist. This flaw is compounded by insufficient transparency. Thus, the Commission's assessment as to whether effective action has been taken cannot be completely validated as the necessary information required for this was not made fully available.[2] The bottom-up approach, in particular, is difficult to verify, it potentially considers only part of the structural developments and opens up considerable *ad hoc* discretionary leeway.

For all the countries concerned, with the exception of Belgium and France, the Commission reports improvements in the structural balance adjusted for the aforementioned factors that exceed the level required.[3] The fact that France was nevertheless judged as having taken effective measures is considered to be justified on the basis of a supplementary analysis of the results of the bottom-up approach. Furthermore, the approach taken in the case of France differs from that taken in a number of other countries. The Commission itself also alludes elsewhere to the fact that this approach is not particularly suitable for measuring a country's fiscal consolidation efforts.[4]

Given the earlier, mostly much more optimistic forecasts of economic developments (second requirement for a deadline extension without stepping up the EDP) and the currently poor cyclical conditions, it also appears justifiable under the existing rules to refrain from demanding the full short-term offsetting of the missed fiscal targets, and hence to tolerate a certain extension of the adjustment paths. The Stability and Growth Pact generally foresees an extension of the deadline by one year. In the case of Spain, France, Slovenia and Cyprus, this provision was overridden in favour of granting an extension of two years, and four years in the case of Cyprus, for these countries to reduce their deficits below the 3% limit. Such a waiving of the standard rule should be reserved for substantiated exceptional cases. Extending deadlines generally results in a slackening of the structural consolidation requirements and corrective action being put off. For those countries with comprehensive assistance programmes, this can also delay progress towards regaining access to the capital markets. Although this could possibly help to reduce the fear of short-term growth losses, it could, at the

2 With regard to the calculation of the adjusted structural balance, for instance, it is not clear to what extent deviations of revenue elasticity from the longer-term average that were already known at the time of the initial recommendation (and which therefore cannot be disregarded ex post) were taken into account.
3 According to the Commission's spring forecast, Portugal achieves the required improvement for 2012 and 2014, but not for 2013.
4 See European Commission: "Measuring the fiscal effort", in the "Report on Public finances in EMU, European Economy 4/2013".

same time, further erode confidence in the binding effect of the fiscal framework and in the sustainability of public finances, and also prolong the vulnerability to unexpected negative shocks.

The amendments to the Stability and Growth Pact and to the Fiscal Compact have significantly strengthened the Commission's role in many Council decisions by introducing reverse qualified majority voting. As the guardian of the EU treaties, the Commission could now more effectively enforce strict compliance with the budgetary rules than was previously the case. The rules have, however, become increasingly complex and allow considerable discretionary scope in many areas. So far, the Commission has not made all of the necessary information available to make its decisions comprehensible. In order to ensure the effectiveness of the rules and broad public acceptance of the decisions, it is also essential to apply the same assessment criteria to all countries. This includes ensuring that the underlying method of analysis is not only applied in an appropriate manner, but also consistently across all countries. Excessive complexity is likely to have an adverse impact on the effectiveness of the rules. A core component of the common fiscal framework is, not least, the speedier imposition of sanctions introduced with the 2011 reform, although these can only achieve the desired preventive effect if they are applied rigorously. However, a general tendency is becoming apparent towards prolonging the consolidation processes. If the rules are relaxed too much by means of exceptions and discretionary leeway, their disciplinary effect risks being lost.

Central government appears to be operating on the assumption that the burdens can be offset by lower interest expenditure in particular. The downward revision of expected nominal GDP growth in the spring forecast has increased the cyclical burden by €3 billion to €6½ billion in the supplementary budget.[6] With burdens from financial transactions unchanged at €5 billion, structural borrowing thus amounts to €13½ billion (prescribed upper limit as defined by the budgetary legislator: €33 billion).[7]

2014 draft budget balance virtually unchanged vis-à-vis benchmark figures, …

As in previous years, the 2014 draft budget, which was passed by central government at the end of June (but which will, of course, need to be resubmitted after the general elections), was based on the benchmark figures adopted in March. Compared with these figures, the budgeted amount for borrowing was reduced slightly by €0.2 billion to €6.2 billion. A new grant to compensate for the deficit that the Energy and Climate Fund is expected to record as a result of the very low CO_2 emission certificate prices will place a burden on the budget. Furthermore, the estimates for privat-

6 The Bundesbank, however, considers the German economy to be within the range of normal capacity utilisation, and the cyclical adjustment procedure employed by the Bundesbank and the ESCB (which also takes the growth structure into account) presents the cyclical component as largely neutral from today's perspective.

7 Central government is contributing €1½ billion to the €8 billion flood assistance fund in order to rebuild federal infrastructure. The remaining amount is being funded equally by central and state government. However, central government will initially finance the full amount and, according to the supplementary budget, this will be included in its entirety in its structural borrowing figure for 2013. State government will pay its cumulative contribution of €4 billion (including interest) over a period of 20 years. Between 2014 and 2019, the federal states will transfer state government turnover tax shares to central government. From 2020 onward (the year in which, as stated in the German constitution, the debt brake will apply to state government, too) state government is to switch to booking contributions on the expenditure side (probably as repayments, which could still be financed by new borrowing) until 2033. Overall, it would appear appropriate, in consolidated terms, to count the actual outflows from the fund for tackling flood damage, which have an impact on the general government deficit, towards central government's debt brake limit (after deducting the part formally attributable to the federal states where applicable).

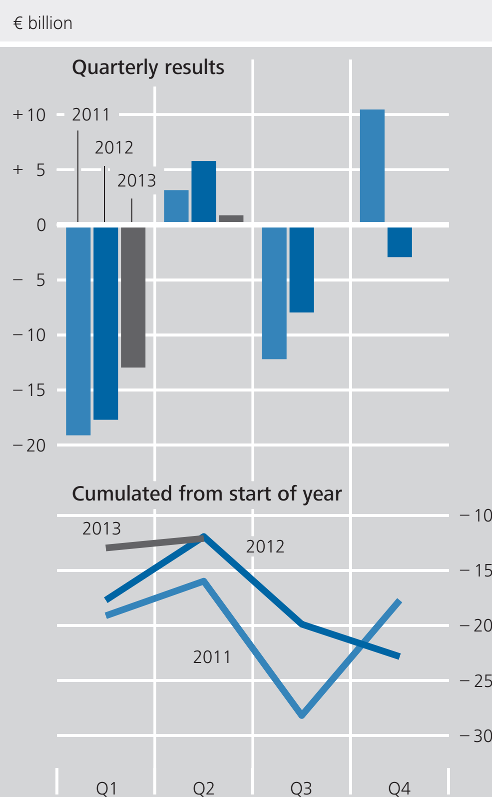
isation proceeds have apparently been reduced. However, this is to be offset by considerable relief stemming above all from interest expenditure (€1½ billion) as well as the Federal Ministry of Labour and Social Affairs (€1 billion).

… but sharp fall in deficit vis-à-vis 2013 supplementary budget target

Compared with the target figure in the 2013 supplementary budget, the 2014 draft budget envisages a sharp reduction of €19 billion in net borrowing. This is predominantly due to temporary burdens in 2013 no longer applying in 2014 (€8 billion flood assistance fund and €4½ billion increase in capital contributions to the ESM), lower interest expenditure (€2½ billion) and a further cut in transfers to the health insurance fund (€1 billion). On the revenue side, projected tax receipts are up by €8 billion, although the introduction of a financial transaction tax generating €2 billion in receipts, which was announced in the 2010 consolidation package, was once again postponed to the following year. By contrast, hardly any privatisation proceeds are envisaged for 2014 (estimate for 2013: €4½ billion).

Slight structural surplus in 2014

In structural terms, central government projected that it would record a surplus of €2 billion in 2014. However, this is based on a calculated cyclical burden of €4½ billion. Given the macroeconomic forecast, which can at least hardly be considered unfavourable, as well as the positive growth structure for public finances, it is likely that this paints too rosy a picture of the structural budgetary situation. Moreover, the budget envisages net expenditure of €3½ billion on financial transactions. In the area of development aid, the plans to book more than €1 billion – formerly recorded as promotional loans (which often have uncertain repayment prospects) – as investment grants in future are to be welcomed. The fact that such payments are consequently counted towards the debt brake limit amounts to an appropriate tightening of the budgetary rules. In this context, the plan to wipe out the existing balance on the control account at the end of 2015, which has now been agreed as part of the package of measures implementing the Fiscal Compact, is also a very positive move.



Fiscal plan envisages gradual increase in structural surplus

The fiscal plan up to 2017, which does not include any of the measures promised in election manifestos, foresees a continual improvement in the fiscal balance, resulting in a surplus of €9½ billion in 2017. In structural terms, a gradual improvement is planned, and a structural surplus of €9 billion is projected for 2017 under the assumption that the forecasted economic circumstances are normal in cyclical terms at that point in time. Interest expenditure is expected to return to notable growth – a cautious assumption which is also advisable given the current financing conditions. If the EU budget is slimmed down as planned, the associated financing burdens might be lower from 2016 onward. On the other hand, there are still budgetary risks, not least with regard to revenue from the financial transaction tax, which is now assumed from 2015 onwards, as well as the planned cutbacks in defence expenditure.

Central government's medium-term fiscal planning from 2013 to 2017 and structural net borrowing under the debt brake

€ billion

Item	Actual 2011	Actual 2012	Target 2013[1]	Draft 2014	Fiscal plan 2015	2016	2017
Expenditure[2]	296.2	306.8	310.0	295.4	299.4	303.1	308.1
of which Investment[3]	25.4	27.6	26.1	25.4	25.2	24.9	24.7
Revenue[2, 4]	278.9	284.3	284.9	289.2	299.6	308.3	317.7
of which Tax revenue[2]	248.1	256.1	260.6	268.7	279.4	292.9	300.5
Net borrowing	17.3	22.5	25.1	6.2	− 0.2	− 5.2	− 9.6
plus cyclical component[5]	1.1	− 7.1	− 6.3	− 4.7	− 3.3	− 1.5	0.0
plus balance of financial transactions[6]	2.0	− 7.4	− 5.2	− 3.7	0.7	0.6	0.5
Structural net borrowing	20.4	7.9	13.6	− 2.2	− 2.8	− 6.1	− 9.1
as a percentage of GDP[7]	0.9	0.3	0.5	− 0.1	− 0.1	− 0.2	− 0.3
Memo item Structural net borrowing[8] Upper limit according to Federal Ministry of Finance	45.6	39.4	33.2	25.6	17.8	9.8	10.1

1 Including supplementary central government budget for 2013. 2 After deducting supplementary central government grants, shares in energy tax revenue, compensation under the 2009 motor vehicle tax reform and consolidation assistance from 2011 onwards, which are all remitted to state government. 3 Excluding participating interests in the ESM. 4 Including proceeds from coin seigniorage. 5 Figures for 2011 and 2012 are taken from the 2012 budgetary accounts. Figure for 2013 as stated in the supplementary budget. For 2014 to 2017, as stated in central government's 2013 spring forecast. 6 As defined for the respective fiscal year. 7 Nominal GDP in the year preceding the drafting of the budget (data for fiscal plan years as stated in 2013 spring forecast). 8 The deficit reduction path from 2011 to 2015 is based on the June 2010 estimate of the starting structural deficit value for 2010 (2.2% of GDP) and a reduction of 0.31% of GDP per year.
Deutsche Bundesbank

Furthermore, there is considerable uncertainty in connection with the debt crisis. There are risks associated with guarantees on assistance loans as well as the indirect impact of the crisis via macroeconomic developments. In such an environment, the targets set for surpluses should be reaffirmed after the general elections. It would even be advisable to try to achieve the safety margin vis-à-vis the permanent structural borrowing limit, which is currently planned from 2017 onwards, ahead of schedule.

Central government's off-budget entities record somewhat higher surplus

At €2 billion, the surplus recorded by central government's off-budget entities in the second quarter was up by €½ billion on the year according to quarterly data from the Federal Ministry of Finance (ie in particular excluding the bad bank FMS Wertmanagement, for which data are not yet available). SoFFin posted a surplus of €1½ billion following repayment of the final portion of its silent participation in Commerzbank. The pension reserves recorded minor surpluses, as had been the case one year previously. Whereas a year ago the precautionary fund for final payments for inflation-indexed Federal securities recorded a surplus of €1½ billion owing to rules-based transfers, in the second quarter of 2013, the first repayment of an inflation-indexed five-year Federal note (Bobl) was due, producing a burden of €1½ billion and thus a slight deficit. For the year as a whole, the revenue surplus of the off-budget entities as reported in the Federal Ministry of Finance's quarterly data (and furthermore excluding the loss compensation paid to FMS Wertmanagement, which does not affect the general government budget balance) is likely to significantly exceed the figure recorded one year earlier (€2½ billion) owing to the advance payment made to the flood assistance fund, as most of these resources will probably not be paid out until the coming years. Central government expects the surplus of the flood assistance fund alone to amount to around €6 billion, while the other off-budget entities, taken

as a whole, could roughly match the figure posted one year previously.

State government budgets[8]

Moderate rise in surplus in Q2

In the second quarter of 2013, state government core budgets once again recorded a more favourable result in year-on-year terms. Their combined surplus went up by €1½ billion to €3 billion. This is due, in particular, to the sharp rise in revenue (7½%, or €5½ billion), which is attributable in almost equal measure to robust tax growth and significantly higher current transfers. The latter include, not least, central government's increased contribution to the basic allowance for the elderly, which is transferred to local government via state government. Expenditure also recorded strong growth (6%, or €4 billion). Central government payments for the basic allowance, passed on via state government, contributed to the increase in current transfers to local government (+€2 billion). Furthermore, spending on personnel in particular rose (+€1 billion). This is due *inter alia* to the 2.65% wage increase for salaried employees, which was paid with retroactive effect from the beginning of 2013.

Moderate deficit reduction in 2013 as a whole

The deficit for the year as a whole is likely to once again be considerably lower than planned (€13 billion), although it will nevertheless probably be only moderately below the figure recorded for the previous year (€5½ billion). According to the May tax estimate, state government tax revenue is expected to record more subdued growth during the remainder of the year. By contrast, expenditure is forecast to carry on growing strongly. Payments to local government in particular are expected to continue to increase significantly, above all as a result of state government increasing its general grants and passing on more funds from central government. In addition to this, the rise in spending on personnel is set to continue as a result of the pay agreement being extended to public sector employees with civil servant status and retired civil servants, albeit with a time lag in many cases and with further restrictions in some federal states.

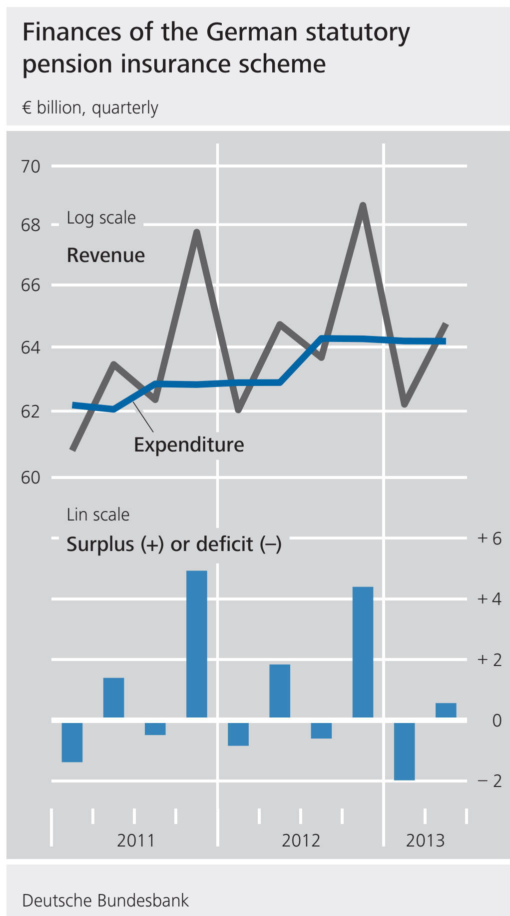
Stability Council highlights need for greater consolidation in Bremen and Saarland

At its seventh meeting in May, the Stability Council found that the five federal states receiving consolidation assistance (Berlin, Bremen, Saarland, Saxony-Anhalt and Schleswig-Holstein) all complied with their structural deficit limits in 2012. Most of the federal states' deficits were even significantly below the limits, with Berlin recording the greatest gap vis-à-vis the ceiling (€1½ billion). However, it will also be important for these five states to make sufficient progress in catching up with the average budgetary position of the other federal states. If this does not happen, there is a danger that the financially-better-off majority in the Bundesrat will pass budget-burdening measures for all federal states, and those states that have not caught up with the others will have problems adhering to the debt brake requirements. The Stability Council monitored the implementation of the agreed restructuring measures in the four federal states previously found to have looming budgetary emergencies (all recipients of consolidation assistance except Saxony-Anhalt). The Council criticised Bremen and Saarland for having made limited progress overall and highlighted the need for them to intensify their consolidation efforts during the period up to 2016.

Progress in enshrining debt brake in constitution in Saxony and Bavaria; implementation act in Hesse

Further progress has been made in implementing the debt brake in state constitutions. In Bavaria, a constitutional rule based closely on the national constitution (Basic Law) was approved by the state parliament with a broad majority. However, the rule is not due to enter into force until 2020. Furthermore, it is still subject to a referendum in September 2013. In Saxony, a constitutional debt brake including the state's special funds was passed by the state parliament with a broad majority and will already apply from 2014 onward. In order to

8 The development of local government finances in the first quarter of 2013 was analysed in the short article in the Bundesbank Monthly Report of July 2013. These are the most recent data available.



Finances of the German statutory pension insurance scheme

take account of cyclical effects, it was agreed to permit borrowing if tax revenue lags at least 3% behind the average value for the preceding four years. Then, tax receipts may be supplemented up to an upper limit of 99% of this average value through borrowing. Future repayments of this borrowing are to be made using additional tax revenue. Further borrowing under a broader exemption clause would have to be approved by the state parliament with a two-thirds majority and would be subject to a repayment plan lasting no more than eight years. This all-round approach is likely to keep debt tightly in check.[9] Furthermore, an implementation act was passed for the debt brake in Hesse. This also requires a two-thirds majority for exemptions. In this case, repayments would, as a rule, have to be envisaged within seven years. In addition to a control account for possible deviations from a structurally balanced budget outturn, a control account is also to be introduced for cyclical effects computed when calculating the budgetary accounts. This makes it easy to monitor whether the symmetry requirement stipulated in the German constitution has been complied with and, where necessary, to take targeted corrective steps. Moreover, the rule requiring debt waivers that do not affect on-budget payment flows to also be counted towards the structural deficit is both in line with European law and advisable. A minimum deficit reduction path was set for the structural deficit, requiring a structurally balanced budget to be achieved by 2019.

Social security funds[10]

Statutory pension insurance scheme

Financial deterioration in Q2 due to cut in contribution rate

The statutory pension insurance scheme recorded a surplus of just over €½ billion in the second quarter of 2013, which was more than €1 billion lower than at the same time last year. While revenue did not exceed the figure recorded a year earlier, expenditure rose by just over 2%. Contribution receipts and transfers from the central government budget stagnated.[11] In both cases, this was primarily due to the cut in the contribution rate from 19.6% to 18.9% on 1 January 2013. Adjusted for this effect, contribution receipts would have increased sharply by just under 4% and central government grants, which are linked to the contribution rate, would also have been considerably higher. On the expenditure side, the rise roughly corresponds to the impact of the mid-2012 pension increase. By contrast, there was

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9 Like the debt brake rule envisaged in Bavaria, there is of course some potential for conflict with the European budgetary rules. The unlimited use of reserves to balance the budget (as is apparently envisaged in both federal states) could cause general government to overstep its structural deficit limit of ½% of GDP, which has to be safeguarded by the national budgetary rules. It would therefore be worth considering an explicit limit.
10 The financial development of the statutory health and public long-term care insurance schemes in the first quarter of 2013 was analysed in the short articles of the June and July Monthly Report editions. These are the most recent data available.
11 General and additional central government grant as well as central government contributions to cover child-rearing periods.

hardly any change overall in the number of pensions paid out. This is attributable to a slight decline in retirement pensions and an increase in pensions for persons with reduced earning capacity. Developments in retirement pensions currently reflect the low birth rates during and straight after the Second World War (persons who are now 65 or older). Furthermore, in 2012 the special age limit for women allowing them to retire at 60 (with a reduced pension) was abolished. The sharper rise in pensions for persons with reduced earning capacity is due to the fact that those born from around 1950 onwards, when birth rates were significantly higher, have now reached an age where there is a relatively high risk of reduced earning capacity. From the middle of the current decade onwards, those born during the post-war baby boom will start to reach the regular retirement age and place a considerably greater strain on expenditure.

Further contribution rate cut in 2014 increasingly likely, …

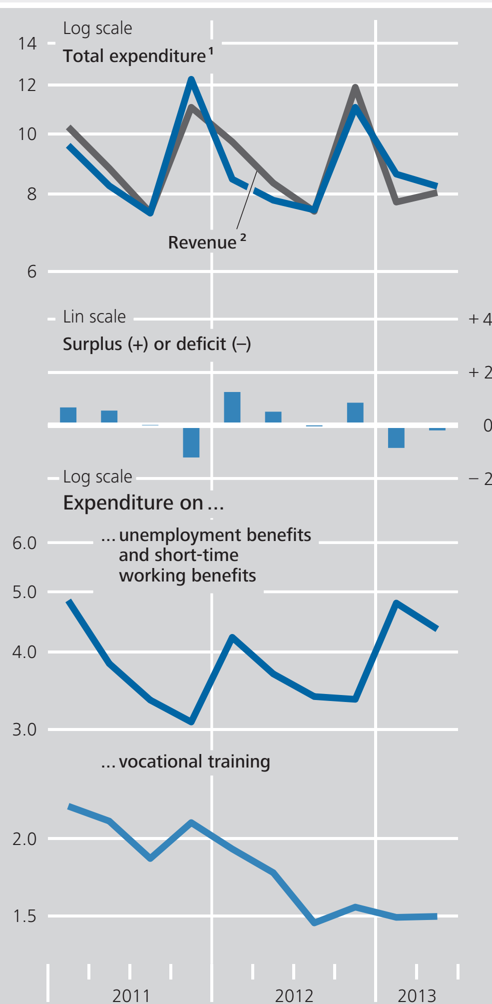
In the first half of 2013, the statutory pension insurance scheme recorded a deficit of just under €1½ billion, which constitutes a year-on-year financial deterioration of just under €2½ billion. When the current contribution rate of 18.9% was set, a sizeable deficit was expected (after a €5 billion surplus in 2012) owing to the need to scale back the reserves to their upper limit of 1.5 times the scheme's monthly expenditure. However, it is now becoming increasingly likely that a surplus will be posted for 2013 and the reserves will continue to exceed the statutory upper limit. This is due not least to the low pension increase of 0.25% in western Germany with effect from 1 July 2013. The contribution rate would consequently have to be cut significantly again in 2014. However, next year certain statistical particularities will no longer apply and, in particular, pension cuts waived in previous years will largely have been clawed back, meaning that considerable pension increases are likely again in 2014. The current favourable situation will have hardly any impact on the longer-term financial outlook, particularly as the present high level of employment is a medium-term goal anyway. It would actually become more difficult to finance pension payments if, in the future, there were not more contribution payers than assumed in the projections to cover the employment-induced higher pension entitlements at the current end. Given the demographic trend, the contribution rate is set to increase in the future anyway.

… but no scope for spending increases over longer term

Overall, the large reserves at present certainly do not provide any long-term financial scope for spending increases. If they were not funded from the central government budget, such spending increases would make it necessary to push the contribution rate up even further in the future. This would also endanger compliance with the legal requirement that the contribution rate must not exceed 22% before 2030.

Finances of the Federal Employment Agency

€ billion, quarterly



1 Including transfers to the civil servants' pension fund. 2 Excluding central government liquidity assistance.
Deutsche Bundesbank

Federal Employment Agency

Deterioration due to termination of central government grant

The Federal Employment Agency recorded a slight deficit in the second quarter of 2013, compared with a surplus of €½ billion one year previously. This deterioration is due entirely to the termination of the central government grant at the start of 2013, which had amounted to nearly €1 billion during the same period of 2012. Overall, revenue was down by 3½% on the year, whereas expenditure rose by almost 5½%. On the revenue side, growth in contribution receipts (just under 4%) was only slightly weaker than during the first quarter. Furthermore, there was substantial additional revenue from insolvency benefit contributions, after this contribution rate was increased from 0.04% to 0.15% at the beginning of 2013. However, the termination of the central government grant outweighed the above factors. On the expenditure side, the strong growth is mainly attributable to an increase in unemployment insurance benefit (I) of close to 15%, which was slightly faster than the pace of growth in the first quarter. Although spending on active labour market policy measures fell by 15%, this amounts to a marked deceleration in the decline compared with the first quarter.

Federal Employment Agency's finances probably better than recently expected, but long-term deterioration from using it as budgetary stopgap

The Federal Employment Agency expects to record a deficit of just under €1 billion for the year as a whole. This figure could improve if, as has often occurred in the past, spending on active labour market policy measures turns out to be lower than estimated in the budget plan. Nevertheless, compared with the previous year, a long-term deterioration in its financial situation is likely owing to the termination of the central government grant being only partially offset by the abolition of the reintegration payment. Consequently, tasks facing society as a whole that have been entrusted to the Federal Employment Agency (such as facilitation measures for trainees from disadvantaged backgrounds), the costs of which the Agency itself estimates at almost €4 billion in total, will be financed from contributions and not from general tax revenue. Alongside central government's refunds of administrative costs, particularly for support for the long-term unemployed, the financial relations between central government and the Federal Employment Agency now essentially only allow loans to be granted if the Federal Employment Agency's own revenue no longer covers its expenditure in a downturn. The Federal Employment Agency might lose approximately €1½ billion a year on balance as a result of the new financial arrangements. There is consequently an increased risk that, with the current contribution rate of 3.0%, the Federal Employment Agency's own receipts will not be sufficient in structural terms to cover its expenditure.