

Public finances*

General government budget

General government budget again broadly balanced in 2013

The general government budget was again broadly balanced in 2013. According to initial preliminary figures, the slight surplus of +0.1% of gross domestic product (GDP) from 2012 reverted to a minor deficit of -0.1% of GDP. While cyclical and specific temporary effects still had an overall positive impact on the budget balance in 2012, these factors no longer played a role in 2013. In a favourable environment with low interest rates and low structural unemployment, the structural fiscal result was also close to balance and thus somewhat better in year-on-year terms. The revenue and expenditure ratios were largely unchanged and stood at 44¾% (for more detailed information, see the box on pages 70 and 71).

Social security funds' surpluses contracting; government-level deficits diminishing

Developments at the various levels of government and the social security funds were mixed. The high surplus run up previously by the social security funds fell considerably by 0.5 percentage point to +0.2% of GDP in 2013. This was due *inter alia* to the cut in the pension contribution rate, a renewed faster rise in healthcare expenditure as well as a shift (which, as plans currently stand, is only temporary in some cases) in burdens away from central government. By contrast, central, state and local government saw their existing deficit (which, at -0.6% of GDP, was still clearly negative overall in 2012) diminish noticeably in 2013 to -0.3% of GDP. This reflects, in particular, the above-mentioned shift in burdens from central government to the social security funds and more favourable funding costs, which are significant given the high level of debt.

Debt ratio declining

The drop in the debt ratio to 78.4% at the end of the third quarter of 2013 (end-2012: 81.0%) was attributable to nominal GDP growth in the ratio's denominator but portfolio reductions at government-owned bad banks also played a role. These factors clearly outweighed the in-

creases in debt brought about by further payments related to the euro-area assistance mechanisms.

From the current perspective, the fiscal balance is expected to barely change in 2014. Cyclical factors and an easing of the debt servicing burden, in particular, could improve public finances slightly, but otherwise the structural position seems likely to remain largely static. Benefit increases in the statutory pension insurance scheme are likely to have only a relatively small impact in 2014 because the changes are not scheduled to become effective until mid-year. The government is also planning additional unfunded expenditure *inter alia* on public infrastructure investment. However, this expenditure is expected to be rather low initially due, not least, to the time lag inherent in major construction projects and the fact that budgetary authorisation is likely to be outstanding for some time.

The debt ratio thus looks set to diminish further this year. With a broadly balanced general government budget, nominal GDP growth in the denominator pushes the ratio down. As things currently stand, portfolio reduction among the bad banks is expected to continue and the debt-increasing impact of the measures already concluded as part of the euro-area assistance mechanisms is lower than in previous years. However, at around 75%, the debt ratio is still well in excess of the ceiling laid down in the Maastricht Treaty.

At the end of 2013, the Federal Ministry of Finance submitted an updated forecast of short and medium-term budgetary developments to

Current perspective: balance expected to barely change in 2014 and ...

... debt ratio set to diminish

Fiscal policy stance eased somewhat

* 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).

The structural development of public finances in Germany – results of the disaggregated framework for 2013

According to the provisional national accounts data from the Federal Statistical Office, Germany's general government budget recorded a small deficit of 0.1% of gross domestic product (GDP) in 2013, compared with a slight surplus of 0.1% of GDP in 2012. Using the "disaggregated framework" for analysing public finances,¹ first, the role played by cyclical influences and specific temporary effects is estimated. Second, other changes, referred to here as structural, in the revenue and expenditure ratios and their major determinants are identified. The main results of this analysis for 2013 are presented below.²

Whereas cyclical factors still had a positive impact on the fiscal balance in 2012, they waned in the wake of the economic slow-down in the fourth quarter of 2012 and the first quarter of 2013, and had a neutral impact on average in 2013. The fiscal balance thus declined by 0.4 percentage point due to cyclical reasons. By contrast, clearly identifiable specific temporary effects had a slightly positive effect (+0.1 percentage point). This is attributable to the absence of the one-off burden in 2012 resulting from the capital transfers as part of the resolution of the public regional bank WestLB. After adjustment for these cyclical influences and specific temporary effects, the structural fiscal balance in relation to nominal trend GDP improved slightly in 2013 by 0.2 percentage point. The structural fiscal balance was thus close to balance.

The unadjusted revenue ratio dropped by 0.1 percentage point, whereas the structural ratio fell somewhat more sharply, by 0.2 percentage point. The decline in the structural ratio was primarily due to legisla-

tive changes (-0.2 percentage point), not least the further cut in the pension contribution rate. The other factors identified in the disaggregated framework did not play an important role in 2013. The slight decline in non-tax revenue reflects in particular the fact that the interest income (as well as the interest expenditure) of government-owned bad banks fell in the wake of their portfolio reductions. As usual, fiscal drag pushed the ratio up somewhat (+0.1 percentage point), whereas structural shifts in the distribution and use of GDP, affecting its "revenue richness", or other factors (residual), such as time lags in the assessment, did not play a role overall in the change in the balance.

The unadjusted expenditure ratio rose slightly by 0.1 percentage point, whereas the structural ratio fell perceptibly (-0.4 percentage point) above all due to the more stable trend GDP in the denominator (compared with that for unadjusted GDP). The interest expenditure ratio decreased further (-0.2 percentage point) owing to the favourable financing conditions and partly also to the above-mentioned portfolio reductions at bad banks.³ The structural ratio of primary expenditure likewise fell by 0.2 percentage point. This was due to a significant extent to the ongoing muted

¹ For a more detailed description of the framework, including the standardised method of determining the cyclical component used in the Eurosystem, see Deutsche Bundesbank, A disaggregated framework for analysing public finances: Germany's fiscal track record between 2000 and 2005, Monthly Report, March 2006, pp 61-76.

² These results are subject to amendments arising from revisions to the national accounts figures or to estimates of the macroeconomic outlook.

³ The determinants of the change in the interest expenditure ratio are not shown because the debt ratio for 2013 is not yet available.

Structural development*

Year-on-year change in percentage points

Item	2007	2008	2009	2010	2011	2012	2013
Unadjusted fiscal balance¹	1.9	-0.3	-3.0	-1.1	3.3	0.9	-0.2
Cyclical component ¹	0.5	0.3	-1.6	0.2	0.8	0.1	-0.4
Temporary effects ¹	0.0	-0.3	0.2	-1.0	1.2	-0.1	0.1
Fiscal balance	1.4	-0.3	-1.5	-0.3	1.3	1.0	0.2
Interest payable	0.0	-0.1	-0.2	-0.1	0.1	-0.2	-0.2
Owing to change in average interest rate	0.1	-0.1	-0.3	-0.3	-0.1	-0.2	
Owing to change in debt level	0.0	0.0	0.1	0.2	0.1	0.0	
Primary balance	1.5	-0.4	-1.8	-0.4	1.3	0.8	-0.1
Revenue	0.8	0.3	-0.7	-0.4	1.0	0.1	-0.2
Taxes and social contributions	0.7	0.2	-0.9	-0.5	0.8	0.2	-0.1
Fiscal drag	0.1	0.0	0.1	0.0	0.1	0.1	0.1
Decoupling of base from GDP	-0.2	0.2	-0.1	0.2	0.2	0.1	-0.1
Legislative changes	0.7	-0.6	-0.3	-0.7	0.2	-0.1	-0.2
Residual	0.2	0.6	-0.6	0.0	0.3	0.2	0.1
of which: profit-related taxes ²	0.2	0.5	-0.6	0.2	0.2	0.2	0.1
Non-tax revenue ³	-0.1	0.0	0.2	-0.1	0.0	-0.1	-0.1
Primary expenditure	-0.7	0.7	1.0	0.0	-0.3	-0.8	-0.2
Social payments ⁴	-0.4	0.2	0.6	-0.2	-0.3	-0.3	-0.2
Subsidies	-0.1	0.0	0.1	0.0	-0.1	-0.1	0.0
Compensation of employees	-0.2	0.0	0.2	0.0	0.0	0.0	-0.1
Intermediate consumption	0.0	0.3	0.2	0.1	0.1	0.0	0.0
Gross fixed capital formation	0.1	0.1	0.1	0.0	0.0	-0.1	0.0
Other expenditure ⁵	-0.1	0.1	-0.1	0.1	0.0	-0.2	0.1
Memo item							
Pension expenditure ⁶	-0.3	-0.1	0.0	0.0	-0.1	-0.2	-0.3
Healthcare expenditure ⁷	0.1	0.2	0.3	0.0	0.0	0.0	0.1
Labour market expenditure ⁸	-0.2	0.1	0.1	-0.3	-0.3	-0.1	-0.1

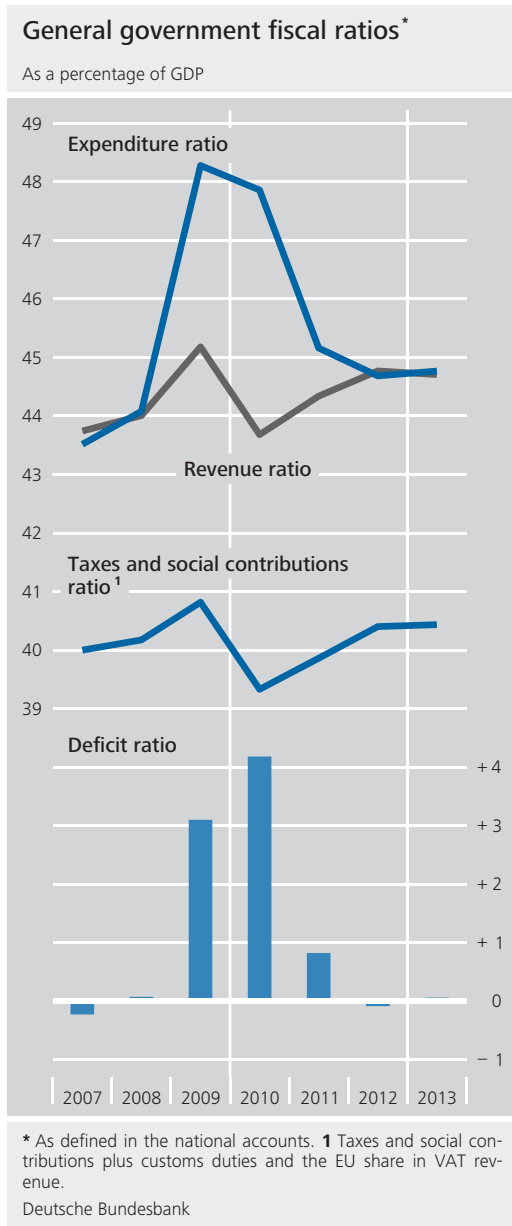
* The structural fiscal balance is defined as an unadjusted balance that is adjusted for cyclical influences and specific temporary effects and set in relation to trend GDP. This table shows the year-on-year change in this ratio. The Maastricht definition is used, ie swaps and forward rate agreements are included in interest expenditure and the fiscal balance. **1** Year-on-year change in the ratio to nominal GDP. **2** Assessed income tax, corporation tax, local business tax, investment income tax. **3** Other current transfers receivable, sales and total capital revenue. **4** Including other current transfers to households. **5** Other current transfers payable to corporations and the rest of the world, other net acquisitions of non-financial assets and capital transfers payable. **6** Spending by the statutory pension insurance scheme, on civil servants' pensions as well as payments by the Post Office Pension Fund and the Federal Railways Fund. **7** Spending by the statutory health insurance scheme and assistance towards civil servants' healthcare costs. **8** Spending by the Federal Employment Agency (excluding the compensatory amount (2007)/reintegration payment (from 2008 to 2012) paid to central government) and central government expenditure on unemployment welfare benefit (II) and on labour market reintegration measures.

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growth in pension expenditure. Furthermore, the structural relief for labour market spending continued. However, healthcare expenditure pushed up the ratio, as did Germany's increased payments to the EU budget (recorded under "Other expenditure" in the table above).

In conclusion, Germany's public finances recorded a close-to-balance result both in unadjusted and structural terms, as they had done the previous year. The tailing off of the positive cyclical impact from 2012 overshadowed the slight structural improvement. The latter was due to the fact that above all the ongoing muted growth in pension expenditure and a further decline

in interest expenditure outweighed cuts in taxes and social contributions, particularly in pension insurance contributions.



the Stability Council. Although the new German government's plans will, on balance, place additional strains on public finances, the forecast envisages that the general government budget will continue to be balanced in 2014 and 2015, and that in the years thereafter up to 2017 it will record a surplus of ½% of GDP.¹ Overall, a general government budget that is at least balanced seems to be compatible with the government's plans as long as all levels pursue a restrained expenditure policy and no further burdens arise.

As part of the European Stability and Growth Pact, Germany has set a medium-term object-

ive of a structural general government deficit ratio of no more than 0.5%. In order to implement the Fiscal Compact with its European partner countries, Germany once again enshrined this ceiling explicitly in national legislation.² The Stability Council was given the task of monitoring compliance with this ceiling and, in the future, will be aided by an independent committee.³ As part of its new mandate, every May and December the Stability Council examines adherence to the ceiling for the current and the following four years. Where necessary, it also proposes appropriate measures to help avoid breaching this ceiling. It carried out this mandate for the first time in December 2013 and – based on estimates by the Federal Ministry of Finance – certified that Germany's structural general government deficit complies with this ceiling. This assessment is currently still valid. However, clearer communication of the policy changes that are included in this examination would be welcome.

Stability Council monitors compliance with ceiling for structural general government deficit

Given Germany's high debt ratio and the burdens associated with demographic change, it is

¹ A structural surplus of ½% of GDP is estimated for each year in the planning period. The cyclical adjustment procedure applied is based on the method used in the EU budgetary surveillance procedure. At the current end, using this procedure results in a distinctly negative cyclical impact on the fiscal balance whereas the Bundesbank's estimation procedure, using a disaggregated framework, (see also the box on pages 70-71) produces a fairly neutral cyclical impact in particular due to the comparatively stable development of key macroeconomic budget variables. Consequently, even under equal conditions, the current structural budgetary situation is estimated to be more favourable using the German government/EU procedure than in the disaggregated framework applied by the Bundesbank.

² The fundamental commitment to the EU budgetary targets already stipulated in the German constitution was outlined in greater detail in the Budget Principles Act (Haushaltsgrundsätzegezet) without transitional periods.

³ See Act concerning the implementation of the Fiscal Compact within Germany (Gesetz zur innerstaatlichen Umsetzung des Fiskalvertrags), 15 July 2013, and for fundamental considerations on the details thereof: Deutsche Bundesbank, Statement on the draft Act concerning the implementation of the Fiscal Compact within Germany (Stellungnahme zum Entwurf eines Gesetzes zur innerstaatlichen Umsetzung des Fiskalvertrags), Bundestags-Drucksache 17/10976, including the accompanying amendment requests from the Budget Committee of 16 November 2012. The committee will comprise nine members, one of whom will be seconded from the Bundesbank. The first statement of the committee is announced for May.

Recommendation to anchor surpluses in medium-term plans still valid

advisable to not exploit the regular ceiling of 0.5% for the structural deficit ratio but instead to continue to target a budgetary surplus in the budget and medium-term plans. In view of the national budget rules, it would be sensible to make the most of the current exceptionally favourable conditions and swiftly reduce the structural deficits still remaining at the central, state and local government levels, and to build up safety margins below the long-term national upper limits. By factoring in safety margins under normal circumstances, short-term corrections can be kept to a minimum, which may otherwise be necessary if the budgetary situation has to be re-evaluated in less favourable times.

Focus on structural improvements would be welcome

In this setting, it would be appropriate for new fiscal policy measures to be largely neutral in budgetary terms and for the focus to be placed on structural improvements within the budgets. Increasing public infrastructure investment as a basis for sustainable economic growth, as central government is planning to do, is an important task. In addition to maintaining the necessary level of infrastructure, the key objective here is not so much to increase expenditure across the board but to focus on eliminating bottlenecks. This could be financed by improving efficiency within the investment budget, shifting budget items or by means of fees. In this context, it should be noted that a marked increase in investment expenditure when production capacity is restricted can lead to price hikes and the real effects may then be correspondingly lower. Investment in education is also to be increased. In this area, too, it is important for any weaknesses to be eliminated in a targeted manner and scope arising from the falling number of school pupils as a result of demographic changes could be used for this purpose. A key future challenge with regard to the social security funds is to maintain their sustainability in the face of demographic change. Close atten-

tion needs to be paid, too, to the substantial burden that is already weighing on younger generations. With demographic factors foreseeably diminishing the labour force, extending working life will play an important role in this regard. By contrast, shortening working life only tends to aggravate the problem still further.

Budgetary development of central, state and local government

Tax revenue

At just under 3½%, tax revenue⁴ continued to record solid growth in 2013 (see the chart below and table on page 74) and was thus broadly in line with the November forecast made by the Working Party on Tax Revenue Forecasting. Receipts from income-related taxes climbed by an above-average 6%. Although the strong increase in wage tax receipts was bolstered by stagnating deductions (for child benefit and subsidies for supplementary private pension plans), it was mainly attributable to ongoing stable wage developments and the growing number of employed persons. Despite the basic income tax allowance being raised, the increase was still boosted by the progressive taxation schedule. Revenue from

Above-average growth in income-related taxes

Tax revenue*

Year-on-year percentage change, quarterly data



Source: Federal Ministry of Finance. * Including EU shares in German tax revenue but excluding receipts from local government taxes.

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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.

Tax revenue

Type of tax	Year as a whole				Estimate for 2013 as a whole ^{1,2,3}	Q4			
	2012		2013			2012		2013	
	€ billion		Year-on-year change € billion	%	Year-on-year change %	€ billion		Year-on-year change € billion	%
Tax revenue, total ²	551.8	570.2	+ 18.4	+ 3.3	+ 3.4	148.4	153.8	+ 5.4	+ 3.6
<i>of which</i>									
Wage tax	149.1	158.2	+ 9.1	+ 6.1	+ 5.9	42.2	44.9	+ 2.7	+ 6.3
Profit-related taxes ⁴	82.5	87.7	+ 5.2	+ 6.3	+ 5.9	18.1	19.9	+ 1.9	+ 10.3
Assessed income tax	37.3	42.3	+ 5.0	+ 13.5	+ 12.0	9.9	10.6	+ 0.7	+ 7.2
Corporation tax	16.9	19.5	+ 2.6	+ 15.2	+ 17.2	3.9	4.8	+ 0.8	+ 20.8
Investment income tax ⁵	28.3	25.9	- 2.4	- 8.4	- 9.0	4.2	4.6	+ 0.3	+ 7.6
Turnover taxes ⁶	194.6	196.8	+ 2.2	+ 1.1	+ 1.4	49.9	50.5	+ 0.6	+ 1.2
Energy tax	39.3	39.4	+ 0.1	+ 0.2	+ 0.2	15.2	15.1	- 0.1	- 0.4
Tobacco tax	14.1	13.8	- 0.3	- 2.3	- 1.4	4.7	4.3	- 0.4	- 7.7

Source: Federal Ministry of Finance and Bundesbank calculations. **1** According to official tax estimate of November 2013. **2** Including EU shares in German tax revenue but excluding receipts from local government taxes. **3** Tax revenue including (still estimated) local government taxes was €2.5 billion above the November 2012 estimate, which formed the basis for the 2013 central government budget plan at the end of 2012. Excluding the effect of legislative changes made since the estimate, tax revenue would have been revised upwards by €2.1 billion. **4** Employee refunds, homebuyers' grant and investment grant deducted from revenue. **5** Withholding tax on interest income and capital gains, non-assessed taxes on earnings. **6** Turnover tax and import turnover tax.

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profit-related taxes continued to rise at an above-average pace (+6½%). While sharp growth in assessed income tax is partly attributable to a fall in deduction amounts (due primarily to the phasing-out of the homebuyers' grant and a much weaker rise in income tax refunds to employees), it also reflects continued dynamic growth in gross revenue. However, the rise in corporation tax revenue, which was just as sharp, was chiefly due to special factors that were also responsible for the fall in income from non-assessed taxes on earnings.⁵ Receipts from withholding tax on interest income and capital gains increased significantly. By contrast, revenue from consumption-related taxes recorded only weak growth overall (+1½%). Despite the next increase in tax rates at the beginning of 2013, revenue from tobacco tax continued to decline. Receipts from turnover tax, which are sometimes affected by payment deferrals even at the turn of the year, grew at a somewhat weaker pace than expected in the November forecast.

Only weak rise in consumption-related taxes

According to the latest official tax estimate, at just over 3%, growth in tax revenue (including local government taxes) is expected to be of a similar magnitude in 2014. Although the macroeconomic reference variables for tax revenue are expected to grow at a significantly faster pace, the volume of receipts will be dented, in particular, by tax refunds envisaged in the wake of court rulings. Furthermore, shortfalls as a result of changes in tax legislation are likely to be somewhat larger on balance than in 2013.⁶

Revenue growth expected to continue on stable path in 2014

⁵ In 2012, tax payments on dividends within groups of companies sharply drove up income from non-assessed taxes on earnings, while the refunds offsetting these payments pushed down corporation tax revenue by a similar amount.

⁶ This estimate assumes that growth in real GDP will accelerate markedly from 0.5% in 2013 to 1.7% in 2014. By contrast, growth in nominal GDP – which is of greater relevance for the tax forecast – is expected to accelerate somewhat less (from 2.6% in 2013 to 3.3% in 2014).

Central government budget

Slight fall in deficit for 2013 overall despite strain from financing flood assistance fund

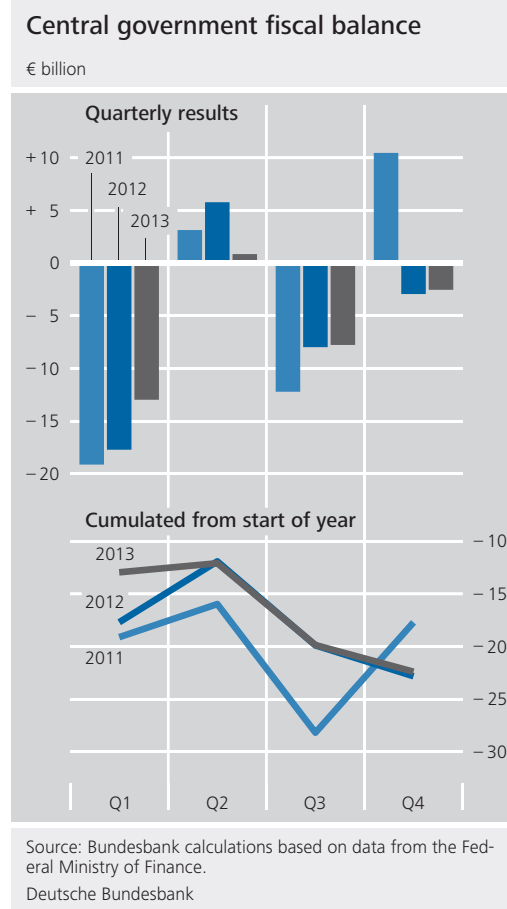
According to the preliminary outturn, central government recorded a deficit of €22½ billion in 2013, which amounts to a slight reduction of €½ billion compared with the actual figure for 2012. Tax receipts went up by only 1% (+€3 billion) as a result *inter alia* of higher transfers to the EU budget (+€5 billion), and other income actually fell by €2 billion chiefly due to the abolition of the Federal Employment Agency's reintegration payment. On the expenditure side, payments to the Federal Employment Agency and the health insurance fund were cut significantly (by a total of €10 billion). The one-off burden from advance payments made to the flood assistance fund in the amount of €8 billion had a particularly negative (expenditure-increasing) impact. Overall, spending thus rose slightly.

Results more favourable than in summer supplementary budget ...

The deficit was €3 billion lower overall than in the summer 2013 supplementary budget. Although tax receipts were down by €1 billion, total income was higher than forecast. In the case of non-tax revenue, the Bundesbank's lower-than-expected profit distribution was more than offset above all by higher payments received from the EU.⁷ Despite various burdens that were not envisaged in the budget – such as the extraordinary transfer of €½ billion to Greece – expenditure was still €2 billion below the authorised level. The largest single contribution to this development came from defence expenditure, although procurement payments – which played a decisive role – are not expected to continue to be so low. Calls on guarantees and interest expenses *inter alia* also undershot the budget appropriations.

... but structural deficit still roughly at estimated level

Structural new borrowing in the core budget, as calculated in accordance with the simplified procedure envisaged in the debt brake provisions, was only marginally below the figure estimated in the supplementary budget.⁸ A more comprehensive evaluation would of course consider the structural balances of the relevant off-budget entities, in particular the flood as-



sistance fund, which ran a high surplus owing to the advance payments received. Overall, the Federal Ministry of Finance put structural new borrowing at 0.23% of GDP, which was thus (as in 2012) compliant with the permanent upper limit of 0.35%, which will apply from

⁷ Central government receives EU funds in conjunction with various measures. If higher-than-expected EU revenue triggers additional expenditure in the same year, this of course does not account for any changes in the fiscal balance vis-à-vis the budget plans.

⁸ In the simplified procedure, potential output is not re-estimated. The figure from the autumn 2012 forecast (when the budget was approved) is taken and the cyclical component used at that time is merely revised to account for any deviations in actual growth in nominal GDP compared with the estimate at that time. According to this calculation, the cyclical burden amounted to €4 billion. After deduction of the net burdens from financial transactions of €4½ billion (in particular due to payments to the ESM of €8½ billion), the structural core budget balance amounted to -€13½ billion (or -0.5% of GDP).

2016.⁹ However, the Bundesbank's cyclical adjustment procedure results in a distinctly lower cyclical burden. The structural balance is thus less favourable and close to the future ceiling.

New government announces notable budget strains but draft budget for 2014 still outstanding

As the new German government was only formed in December 2013 and key changes have been made vis-à-vis the areas of responsibility for the budget, a new draft central government budget for 2014 is not yet available. The coalition agreement maps out a target of achieving a structurally balanced budget this year. However, at the same time, the government has also announced unfunded measures for the central government budget with a total additional burden of €23 billion for the entire legislative period. These measures include, in particular, transfers for research, education and childcare (€9 billion in total), investment in transport infrastructure (€5 billion), relief for local government for integration assistance (€3 billion) and payments to the statutory pension insurance scheme (€2 billion), whereby the latter is not likely to be attributable to burdens from waiving the cut in the pension contribution rate in 2014.¹⁰ However, it is still not clear how the burdens envisaged for the entire legislative period will be divided among the individual years.

Target of structurally balanced budget in 2014 leaves little scope for additional unfunded expenditure

It is fair to assume that the additional costs will be incurred only gradually. For the 2014 budget where, despite slightly more favourable results at the end of 2013, there has probably been no improvement in the starting situation, planned new borrowing may nevertheless only marginally exceed the hitherto budgeted amount of €6 billion if the structurally balanced budget agreed by the coalition parties is to be achieved. According to the Annual Economic Report published recently, the cyclical burden to be deducted from the structural deficit amounts to €5½ billion.¹¹ The outgoing government calculated burdens of €3½ billion on balance from financial transactions.¹² Given the considerable outflows of funds from the flood assistance fund that are expected in 2014, achieving a structurally balanced central government

budget overall as defined in the debt brake provisions ultimately means that the core budget will have to run a commensurate surplus. In light of all this, there appears to be very limited scope for unfunded expenditure compared with the summer 2013 plans.

As things stand, the same overall picture applies to 2015; the coalition agreement envisages no net new borrowing in the 2015 budget, as was specified in the financial plan of summer 2013. There are risks stemming from the assumption in the summer 2013 financial plan that a financial transaction tax would be in place in 2015 and would bring in revenue of €2 billion, and from factored out wage adjustments. The euro-area debt crisis, which has not yet been overcome, is another source of uncertainty for the central government budget, not least regarding guarantees on assistance loans and possible repercussions on macroeconomic developments. Further delays in reducing the high government debt levels would be counterproductive to the aim of limiting budget burdens, which are already on the rise because of demographic change. Central government

Risks and demographic burdens give grounds for a cautious fiscal policy

⁹ According to the initial national accounts data, another large credit balance of over €27 billion would provisionally be booked to the control account at the beginning of March, thus pushing up the total balance accrued since the 2011 budget year to way over the +€80 billion mark. However, when the Act concerning the implementation of the Fiscal Compact within Germany was approved in summer 2013, it was resolved that the extensive credit balance accumulated during the transitional period will be cancelled in 2016, meaning that this will no longer be available to justify higher borrowing by central government.

¹⁰ Taken in isolation, a higher pension contribution rate results in a higher central government grant to the statutory pension insurance scheme. As the outgoing government's budget planning was based on a constant pension contribution rate, the decision that has been taken in the meantime not to cut the rate in 2014 has not resulted in any additional burdens compared with the earlier budget.

¹¹ By contrast, if the standardised ESCB procedure is used, which in particular also considers the growth structure, the cyclical impact on the fiscal balance is broadly neutral. Overall, given the symmetry requirement stipulated in the German constitution, it will have to be examined going forward whether the positive and negative cyclical effects balance each other out over time or whether there might be a tendency to calculate negative cyclical effects.

¹² These transactions comprise a €4½ billion contribution to the ESM and €½ billion in loans granted chiefly for development aid on one side, and loan repayments of €1 billion and privatisation proceeds of now only €¼ billion on the other side.

should therefore use the surpluses aimed for previously to reduce its debt. It would then have to fund any benefit increases by increasing its revenue or lowering its expenditure.

Off-budget entities record large surplus in 2013 Q4 and thus also for year as a whole

After recording a slight deficit a year earlier, central government's off-budget entities (excluding bad banks and the loss compensation payments they receive) posted a surplus of €8 billion in the final quarter of 2013 thanks to the advance payments made to the flood assistance fund. They thus recorded a surplus of almost €11 billion for 2013 as a whole, compared with €4½ billion one year previously. On balance, this rise was mainly due to the advance payments made to the flood assistance fund, whose outflows, at €½ billion, remained fairly limited. Despite the prices for CO₂ emission permits being far lower than expected in the budget plans, the Energy and Climate Fund still almost balanced its budget as outflows were much smaller than planned and the KfW banking group (*Kreditanstalt für Wiederaufbau*) issued a €¼ billion cost assumption commitment. The balance recorded by the Financial Market Stabilisation Fund (SoFFin) was boosted by the final repayment of €1½ billion from Commerzbank to pay off the fund's silent participation. By contrast, one factor driving up the off-budget entities' aggregate outlays was the first redemption of an inflation-linked central government security which, in order to offset the amount by which the redemption exceeded the issue price, led to outflows of €1½ billion from the precautionary special fund set up for that purpose. There are currently no signs that SoFFin, which will remain in existence up to the end of this year, will need to disburse funds for new financial market stabilisation measures in 2014. Outflows from the flood assistance fund, which are likely to be high, will probably cause notable burdens, although these could be offset by surpluses of at least a similar size, not least at the precautionary special funds for civil servant pensions and for redemptions of inflation-linked central government securities.

State government budgets¹³

The aggregate deficit in the core state government budgets came to only €½ billion in 2013, compared with €5½ billion in 2012. Growth in revenue amounted to just over 4½% (€14 billion) and was largely driven by robust tax growth (+4½%, or just over €9 billion). At the same time, transfers received by state government also rose sharply (+5½%, or €3½ billion), not least because of the increase in funds provided by central government for the basic allowance for the elderly, which are transferred via state government to the municipalities. By contrast, proceeds from asset realisations declined (-€1 billion). Expenditure grew at a somewhat slower pace, but still rose by 3% (or just under €9 billion). This increase was largely due to higher transfers (+7%, or just over €5 billion) and staff costs (+3%, or €3 billion), although in many cases the negotiated pay rise was extended to civil servants and retired civil servants only in part or with a delay. Other operating expenditure likewise increased sharply (+4%, or €1 billion), while the steep decline in interest expenses (-5½%, or -€1 billion) continued and investment outlays decreased slightly, even after deducting the one-off capital repayment from North Rhine-Westphalia to SoFFin in 2012.

Only very small deficit in 2013 thanks to robust tax revenue

Despite the significant fall in their aggregate budget deficit, the budget balances of the individual federal states still differ widely. Budget surpluses were recorded in Bavaria, in all of the non-city states in eastern Germany and in two of the federal states undergoing a restructuring programme (Berlin and, for the first time in more than 50 years, Schleswig-Holstein), some higher than in the previous period. In spite of the favourable underlying conditions for tax revenue and interest expenses, however, some states – most notably North Rhine-Westphalia, Hamburg, Rhineland-Palatinate, Hesse, Bremen

Budget balances of individual federal states still differ widely

¹³ The development of local government finances in the third quarter of 2013 was analysed in the short articles of the Bundesbank's January 2014 Monthly Report. These are the most recent data available.

and Saarland – still recorded deficits, some of them very large.

Favourable developments expected to continue, but ongoing need for consolidation in states posting deficits

A further slight improvement in the federal states' aggregate balance is expected for this year. Growth in tax revenue is likely to be similarly robust to last year, while the expenditure pressures caused by higher payments to the municipalities and by further adjustments to wages and pension payouts will continue. Over the entire legislative period, the coalition agreement has earmarked funds of at least €6 billion to ease the financial burden on federal states, including their municipalities, in the areas of day care for small children, schools and higher education. While at least some of these central government funds are likely to go towards further improving state government fiscal balances, some states still need to substantially consolidate their finances. Ultimately, it is doubtful whether the consolidation path initiated by the federal states will be sufficient to ensure that each and every one of them meets the strict debt brake requirements applicable from 2020 onwards.

Stability Council critical of developments in Bremen in particular, but also in Saarland

At its meeting in December, the Stability Council took a positive view of the consolidation efforts made in Berlin and Schleswig-Holstein, which are both undergoing a restructuring programme. As in May 2013, however, it expressed reservations about the budget plans in Bremen and Saarland, which both have especially high debt levels. The Stability Council concluded that Bremen had further eroded its safety margins below the agreed borrowing limit, a development which was attributed to additional planned expenditure. As the measures taken so far might not suffice for Bremen to successfully complete its restructuring programme, the Stability Council has, in accordance with section 5 (3) of the Stability Council Act (*Stabilitätsratsgesetz*), called on Bremen for the first time to intensify its budget consolidation and to present measures to that effect in April. For the state of Saarland, the council even identified additional consolidation needs for 2015 and 2016 which were not covered in the restructur-

ing report but only in a supplementary document submitted by Saarland at a later date. However, Saarland is merely required to provide more details on the measures described in this supplementary document and on the additional plans intended to widen its narrow safety margin. As the Stability Council does not have any real power to impose sanctions if restructuring measures are found to be inadequate, it currently appears uncertain whether the stricter consolidation path the council has called for will actually be implemented.¹⁴

The agreed general budget surveillance procedure does not usually take account of off-budget entities and does not record any (non-specific) global items or balances from financial transactions.¹⁵ The data are not fully harmonised in terms of the stage of budget planning reached in each of the federal states. Overall, there are major limitations to the transparency and comparability of the states' final budget figures and budget plans. As well as a more sensitive warning system, it would be desirable to establish modified, harmonised reporting in order to inform the general public in a targeted manner. It would appear advisable to make budget surveillance more stringent so as to ensure that undesirable developments are flagged at an early stage.

Advisable to fundamentally improve budget surveillance

¹⁴ One year after calling on a federal state to intensify its restructuring efforts, the Stability Council must check whether the necessary measures have been taken. If not, it merely repeats its call for greater efforts. Only if a federal state breaches the borrowing limits at budget outturn up to 2019, which were agreed separately in connection with consolidation assistance, can the Stability Council cut these funds for the year in question.

¹⁵ For states receiving consolidation assistance or undergoing restructuring programmes, financial transactions are taken into account, off-budget entities are included in the evaluation of whether annual borrowing limits have been adhered to and global items are identified as warranting action. Despite a broad base of data being available in the context of general budget surveillance, the off-budget entities of the other federal states are still only monitored on a case-by-case basis in instances where the threshold for the fiscal ratios has been breached. In cases where states' off-budget entities have fairly substantial deficits, there is therefore a danger of the budgetary situation being misjudged.

■ Social security funds¹⁶

Statutory pension insurance scheme

Unexpectedly large surplus in 2013 due to higher contribution receipts and lower expenditure

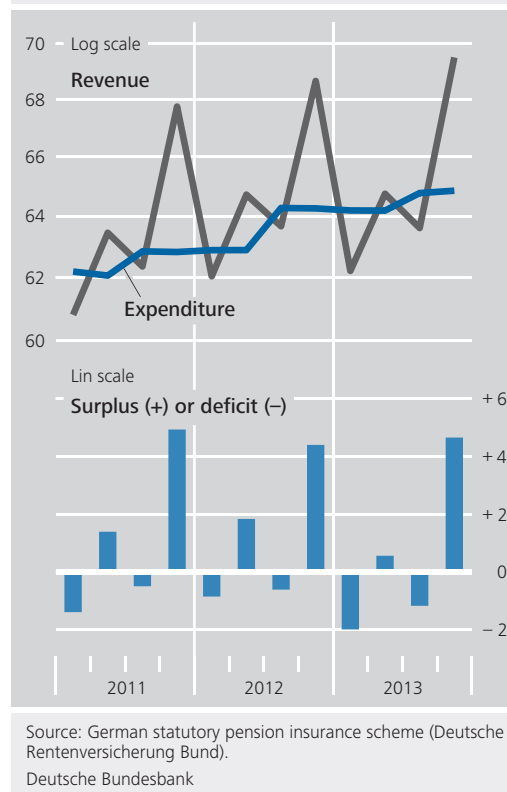
The statutory pension insurance scheme posted a surplus of around €2 billion in 2013, whereas a deficit of roughly the same size had been expected in the budget plan. One of the main reasons for this surprisingly positive outcome was that, despite the contribution rate having been lowered from 19.6% to 18.9%, contribution receipts still rose by almost ½%, mainly as a result of the unexpectedly strong growth in employment. Had the contribution rate remained unchanged, contribution receipts would have increased by 4%. Another reason for the unexpectedly favourable budget balance was that the mid-year pension increase of 0.25% in western Germany was significantly lower than originally estimated. A final factor was that the number of pensions paid out on average across the year did not increase any further in 2013. This was due to the statutory retirement age being raised by another month, the abolition of the lower statutory retirement age for women in 2012 and the relatively small number of people in the age groups currently entering retirement. The latter phenomenon will change in the second half of this decade, when the post-war baby boomers start to reach the statutory retirement age. Overall, the statutory pension insurance scheme's revenue rose by just under ½% and its expenditure by 1½% in 2013. The scheme's surplus for 2013 was thus less than half the size of that posted a year earlier, but its financial reserves, amounting to 1.8 times its monthly expenditure (€32 billion), reached a new high following their last peak in 1993.

Decision not to lower contribution rate leading to high additional revenue ...

Under the legal requirements, the contribution rate should have been lowered to 18.3% at the start of 2014 in order to bring the reserves back down to their upper limit of 1.5 times the scheme's monthly expenditure by the end of the year. Central government chose not to put forward the statutory ordinance needed to im-

Finances of the German statutory pension insurance scheme

€ billion, quarterly data



plement this reduction, however. Instead, the contribution rate for this year is to be fixed by law at its current level. Although the Contribution Rate Act for 2014 (*Beitragssatzgesetz 2014*) has not yet been passed, central government announced its intention to leave the contribution rate unchanged in the Federal Law Gazette (*Bundesgesetzblatt*), referring to the first reading of the draft act in the Bundestag in December 2013. The decision not to lower the contribution rate will lead to additional revenue totalling €7½ billion (€6 billion more in contribution receipts and just over €1½ billion more in central government grants, which are largely adjusted according to the contribution rate). However, the scheme faces substantial additional expenditure, which, according to the draft Act on Improvements in Pension

... but scheme faces substantial additional expenditure

¹⁶ The financial development of the statutory health and public long-term care insurance schemes in the third quarter of 2013 was analysed in detail in the short articles of the Bundesbank's December 2013 Monthly Report. These are the most recent data available.

Insurance Benefits (*Rentenversicherungs-Leistungsverbesserungsgesetz*) adopted by the Federal Cabinet, is expected to total €4.4 billion this year, rise to double that amount in 2015 and reach around €11 billion per year by 2030. An additional year per child is to be counted towards pension entitlements for periods spent rearing children born before 1992, and 63-year-olds¹⁷ who have accumulated 45 contribution years (including some periods where they were unemployed and received social benefits) are initially to be allowed to retire on a full pension without actuarial deductions. For those receiving a disability pension, the reckonable time is to be extended by two years, among other measures. Yet there is great estimation uncertainty, above all concerning the fiscal impact of expanding the possibilities for early retirement. Should more beneficiaries than assumed in the draft legislation opt for early retirement because of the new incentives, this would very quickly place higher additional burdens on the pension insurance scheme, as it would immediately lead to additional pensions being paid out and reduce contribution receipts.

Cap of 22% on contribution rate up to 2030 cannot be maintained without additional central government funds

The latest projections foresee a reduction of the reserves over the second half of this decade to 0.2 times the scheme's monthly expenditure. The contribution rate must then be increased far enough that the current revenue it generates covers the scheme's current expenditure, which will be higher than it is now. However, the stabilisers in the pension adjustment formula will lower the annual pension increase and thus also the general pension level, thereby reducing the amount by which the contribution rate will need to be raised. Unlike general benefit increases, which were last implemented on a substantial scale in 1998 (albeit accompanied by further measures aimed at ensuring that the finances of the statutory pension insurance scheme remained sustainable), the planned changes are not intended to raise the general level of benefits in the scheme but to channel more funds to specific groups of insured persons. Consequently, the level of benefits for

those who do not fall into these categories will be lower in both relative and absolute terms.¹⁸ In effect, the planned measures will lead to a redistribution of funds at the expense of both contribution payers and of pensioners outside the categories benefiting from the changes. The draft legislation already recognises that, in view of these benefit increases, the cap of 22% on the contribution rate up to 2030 cannot be maintained without additional funds being channelled from the central government budget to the statutory pension insurance scheme. Whether the increases to the central government grant which are factored in for this reason from 2019 onwards will ultimately be sufficient will depend, notably, on actual retirement behaviour. All in all, the adopted measures will place a burden on younger generations and on pensioners who do not fall into the categories benefiting from the changes and will exacerbate the existing problem of a shrinking potential labour force and a growing social contributions burden.

Federal Employment Agency

Last year, the Federal Employment Agency's revenue fell by almost 13% and its expenditure decreased by 6½%. This reflects the financial loss the agency incurred as a result of the abolition of the rules-based payment flows between itself and the central government budget (central government grant and reintegration

Balance worsened in net terms by abolition of rules-based central government grant and of reintegration payment

¹⁷ Access to a full pension without actuarial deductions once the claimant has turned 63 will only be possible up to the end of 2015. From 2016 onwards, the age at which claimants can draw a full pension will increase by 2 months each year. Those born in 1964 will not be able to draw a full pension until they are 65, although some periods of unemployment will also still be counted towards pension entitlements.

¹⁸ The contribution rate increase, viewed in isolation, will need to be larger as a result of the additional expenditure. In addition, the calculated pensioner ratio will increase because the number of "equivalent pensioners", which is part of the equation used to obtain this ratio, is calculated by dividing the total (higher) pension expenditure by the standard pension of the average earner who has accumulated 45 contribution years (which is not directly affected), and because early retirement reduces the number of contribution payers. Both of these factors will lead to smaller general pension increases in future.

payment). After adjustment for these effects, revenue increased by 7½% and expenditure by 5%. While the Federal Employment Agency's budget balance was only slightly positive in 2013 following a surplus of €2½ billion in 2012, its finances would have improved by just over €½ billion if the payment flows between the agency and central government had been left unchanged.

Impact of expenditure growth absorbed by favourable contribution receipts

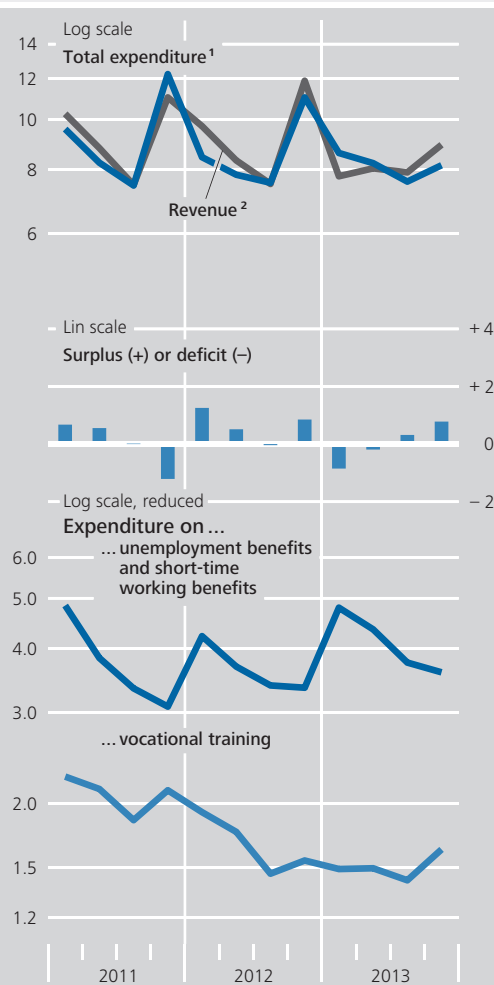
Contribution receipts grew by almost 4% in 2013, particularly as a result of the favourable developments in employment and wages. Furthermore, the Federal Employment Agency received substantial additional revenue from insolvency benefit contributions, for which the contribution rate was raised from 0.04% to 0.15% at the start of the year. Spending on unemployment insurance benefit (I) grew by 11½%, reflecting, in particular, the rise in unemployment in 2013. However, the year-on-year rates became progressively smaller over the course of the year. By contrast, there was another substantial decline (of almost 10%) in spending on active labour market policy. Yet this expenditure item appears to have reached or even passed its lowest point; it was 5% up on the year in the final quarter of 2013.

Slight surplus in 2014 budget plan, but better outcome possible as things stand

The Federal Employment Agency's budget plan shows a slight surplus for 2014. It estimates that revenue will rise by 2½% and expenditure by just over 2%, and assumes that income subject to compulsory contributions will increase by just under 3%. A reduction of 4½% in spending on unemployment benefits is planned, while expenditure on active labour market policy is to increase substantially (by 12%). As things stand, more favourable developments in contribution receipts are not an unrealistic prospect. In addition, the expenditure appropriations for vocational training may well prove to be generous, as they were in the preceding years. Consequently, the possibility of a better-than-planned budget balance cannot be

Finances of the Federal Employment Agency

€ billion, quarterly data



Source: Federal Employment Agency. **1** Including transfers to the civil servants' pension fund. **2** Excluding central government liquidity assistance.
 Deutsche Bundesbank

ruled out, although it is important to note, as a general point, that this is especially dependent on economic developments. In the medium term, the Act on Improvements in Pension Insurance Benefits poses additional risks to the Federal Employment Agency's finances. If, as in the past, the expanded possibilities for drawing a full pension without actuarial deductions are used to combine up to two years of unemployment insurance benefit (I) with early retirement, this will likewise increase the Federal Employment Agency's outlays.