Public finances*

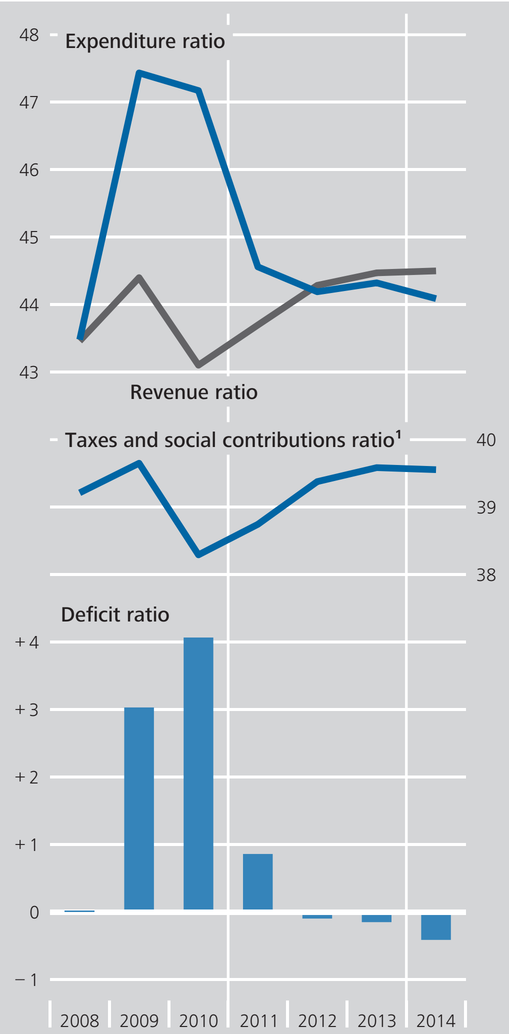
General government budget

2014: sizeable surplus and …

The public finance situation in Germany improved over the past year. The initial report released by the Federal Statistical Office indicates that the general government budget recorded a sizeable surplus of 0.4% of gross domestic product (GDP) (2013: +0.1%). With cyclical factors largely neutral, the structural surplus was at a similar level.[1] On balance, the year-on-year improvement was attributable to lower interest expenditure. The expenditure ratio fell somewhat to 44.1% as a result, while the ratio of primary expenditure (excluding interest expenditure) to GDP barely changed. Although the increase in social payments was markedly higher than nominal GDP growth, smaller rises were recorded in other areas of expenditure. The revenue ratio (44.5%) was unchanged on the year. While the surplus in the social security funds dipped slightly due to accelerated expenditure growth, the central government budget balance saw a significant improvement owing to lower interest expenditure and the higher Bundesbank profit (see further information on general government budget developments on pages 61 and 62).

General government fiscal ratios*

As a percentage of GDP



* As defined in the national accounts. **1** Taxes and social contributions plus customs duties.

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… declining debt ratio

The debt-to-GDP ratio had fallen to 74.8% by the end of the third quarter of 2014 (end-2013: 76.9%) and is likely to have declined further by the end of 2014. The significant drop in the first three quarters of 2014 was primarily attributable to nominal growth in GDP in the ratio's denominator and buoyed by the further slight portfolio reduction at government-owned bad banks, while assistance loans granted to euro-area countries and payments to the European Stability Mechanism (ESM) increased the debt ratio.

2015: deterioration in balance and continued decline in debt-to-GDP ratio

The fiscal balance is likely to deteriorate further in the current year, but will probably remain in positive territory. The impact of cyclical factors on government budgets is set to remain broadly

* The section entitled "General government budget" concerns the national accounts and the Maastricht ratios. The subsequent reporting on the budgets of central, state and local government and of 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** Calculated using the Eurosystem's cyclical adjustment method. For more details, 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. By contrast, the cyclical adjustment procedure used for EU budgetary surveillance and for the central government's debt brake when drawing up the budget paints a clearly negative picture of the economic situation in 2013 and 2014.

The structural development of public finances in Germany – results of the disaggregated framework for 2014

According to the provisional national accounts data published by the Federal Statistical Office in January, Germany's general government budget recorded a notable surplus in 2014. Compared with the virtually balanced result in 2013 (+0.1% of GDP), the general government fiscal balance has improved to +0.4% of GDP. Using the "disaggregated framework" for analysing public finances,[1] first, the role played by cyclical influences and specific temporary effects[2] is estimated. Second, other – referred to here as structural – changes in the revenue and expenditure ratios and their major determinants are identified. The main results of this analysis for 2014 are presented below.[3]

On average, cyclical factors had a broadly neutral impact on the fiscal balance in 2014 – both in terms of the amount by which it changed and its overall level. After adjustment for cyclical influences, the structural fiscal balance in relation to nominal trend GDP improved by 0.2 percentage point. The structural surplus was thus roughly the same as the unadjusted level.

The unadjusted revenue ratio remained unchanged in 2014 and structural revenue in relation to trend GDP rose slightly (+0.1 percentage point). There was no net change in the structural tax and social contributions ratio. While fiscal drag pushed the ratio up somewhat, this was partly offset by shortfalls arising from legislative changes (such as, above all, the increase in the basic income tax allowance). The key revenue reference variables developed broadly in line with nominal trend GDP and, unlike in previous years, there were no significant one-off developments.[4]

The unadjusted expenditure ratio dropped by 0.2 percentage point in 2014. The structural ratio, however, fell only slightly (-0.1 percentage point), mainly because trend GDP in the ratio's denominator grew at a somewhat weaker pace than GDP on average in 2014. The interest expenditure ratio continued to wane, chiefly due to favourable financing conditions.[5] By contrast, the structural ratio of other expenditure (primary expenditure) went up by 0.2 percentage point overall. This increase was driven by significant net growth in social payments, predominantly for healthcare. Pension expenditure grew roughly in line with nominal trend GDP. Growth accelerated rapidly compared with previous years largely due to payments for the pension benefits package, which was not implemented until the second half of the year. However, the further (slight) decline in labour market expenditure provided some relief.

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 In the definition used here, temporary effects were of no significance in 2014.
3 These results are subject to amendments arising from revisions to the national accounts figures or to estimates of the macroeconomic outlook.
4 Receipts from profit-related taxes, in particular, generally fluctuate to a much greater extent than the changes in entrepreneurial and investment income (which are used as macroeconomic reference variables) and the estimated fiscal impact of legislative changes would suggest. However, no major distortions have been observed in this area of late.
5 The exact breakdown of the change in the interest expenditure ratio is not shown because the debt ratio for 2014 is not yet available.

Structural development*

Year-on-year change in the ratio to nominal trend GDP in percentage points

Item	2008	2009	2010	2011	2012	2013	2014
Unadjusted fiscal balance[1]	– 0.3	– 3.0	– 1.0	3.2	1.0	0.1	0.3
Cyclical component[1]	0.4	– 1.7	0.3	0.9	0.0	– 0.4	0.1
Temporary effects[1]	– 0.3	0.2	– 1.0	1.1	– 0.1	0.1	0.0
Fiscal balance	– 0.4	– 1.4	– 0.4	1.2	1.0	0.4	0.2
Interest payable	0.0	– 0.2	– 0.1	0.1	– 0.2	– 0.3	– 0.3
Owing to change in average interest rate	0.0	– 0.3	– 0.4	– 0.1	– 0.2	– 0.3	
Owing to change in debt level	0.0	0.1	0.2	0.1	0.0	0.0	
Primary balance	– 0.4	– 1.6	– 0.5	1.3	0.8	0.0	– 0.1
Revenue	0.3	– 0.8	– 0.2	1.0	0.2	0.0	0.1
Taxes and social contributions	0.2	– 1.0	– 0.4	0.7	0.3	0.1	0.0
Fiscal drag[2]	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Decoupling of macroeconomic reference variables from GDP	0.2	– 0.4	0.3	0.3	0.1	0.0	0.0
Legislative changes	– 0.6	– 0.3	– 0.6	0.2	– 0.1	– 0.2	– 0.1
Residual	0.4	– 0.4	– 0.1	0.1	0.1	0.2	– 0.1
of which: profit-related taxes[3]	0.5	– 0.6	0.3	0.2	0.2	0.1	– 0.1
Non-tax revenue[4]	0.1	0.2	0.2	0.3	– 0.1	– 0.1	0.1
Primary expenditure	0.6	0.8	0.3	– 0.2	– 0.6	0.0	0.2
Social payments[5]	0.2	0.2	0.0	– 0.3	– 0.3	– 0.1	0.3
Subsidies	0.0	0.3	– 0.1	– 0.1	– 0.2	0.0	0.0
Compensation of employees	0.1	0.1	0.1	0.0	0.0	– 0.1	0.0
Intermediate consumption	0.2	0.2	0.2	0.1	0.0	0.0	0.0
Gross fixed capital formation	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Other expenditure[6]	0.0	– 0.2	0.1	0.0	– 0.1	0.2	– 0.1
Memo item							
Pension expenditure[7]	0.0	– 0.1	0.0	– 0.1	– 0.2	– 0.2	0.0
Healthcare expenditure[8]	0.2	0.2	0.1	0.0	0.0	0.2	0.2
Labour market expenditure[9]	0.1	0.1	– 0.3	– 0.3	– 0.1	– 0.1	– 0.1

* The structural figures are derived by adjusting for cyclical influences and specific temporary effects. **1** Year-on-year change in the ratio to nominal GDP. **2** In this context, the term "fiscal drag" encompasses the overall (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. **3** Assessed income tax, corporation tax, local business tax, investment income tax. **4** Other current transfers receivable, sales and total capital revenue. **5** Including other current transfers to households. **6** Other current transfers payable to corporations and the rest of the world, other net acquisitions of non-financial assets and capital transfers payable. **7** 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. **8** Spending by the statutory health insurance scheme and assistance towards civil servants' healthcare costs. **9** Spending by the Federal Employment Agency (excluding the compensatory amount (up to 2007)/reintegration payment (from 2008 to 2013) paid to central government) and central government expenditure on unemployment welfare benefit (II) and on labour market reintegration measures.

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In conclusion, Germany's public finances recorded a notable surplus in 2014, both in unadjusted and structural terms. The year-on-year structural improvement was attributable to a further fall in interest expenditure. Structural strains resulting from a significant rise in social payments were partly offset by favourable developments in other areas (such as higher profit distribution by the Bundesbank). Overall, the structural primary balance deteriorated slightly.

neutral. Social payments are forecast to continue to climb considerably in 2015 and marked increases are expected in other areas, such as transport infrastructure, education and research. Overall, rising budget burdens are likely to outstrip the relief provided by low interest rates. The revenue ratio is projected to remain on a stable course. In particular, the lower pension contribution rate and slight cut in additional contributions to the statutory health insurance institutions will broadly compensate for the higher contribution rate to long-term care insurance. The rapid reduction of the debt-to-GDP ratio, chiefly as a result of GDP growth in the ratio's denominator and buoyed by the portfolio reduction at bad banks, is set to continue.

Neutral budget stance in 2013 and 2014, but interest cost savings

After recording a surplus in 2014, the general government budget has now remained at least balanced for the third year in a row and, with the current plans in place, this trend is set to continue. The balance has improved markedly in structural terms since 2012; however, this was largely due to low interest rates and the resulting fall in interest expenditure. The budget stance remained broadly neutral, meaning that the ratio of the cyclically adjusted primary balance to GDP barely changed.

Keep government budget at least balanced on average over the business cycle

Achieving a government budget position that is at least balanced on average over the business cycle makes an important contribution to reducing the high debt ratio to around 60% by the end of this decade. Not least in view of the fact that demographic strains will subsequently intensify, maintaining the moderate structural surplus as well would not be an overambitious objective. Furthermore, there is an ongoing need for consolidation in some federal states to ensure that the national debt brake is met across Germany from 2020 at the latest. Above and beyond that, it is advisable to factor in clear safety margins vis-à-vis the strict national deficit ceilings under normal circumstances in the form of surpluses. Given the difficult macroeconomic environment at the European level, however, the fiscal plans so far for the general government budget seem appropriate. These plans envisage a notable structural deterioration this year, chiefly owing to the depletion of the social security funds' reserves. Unexpected cyclically induced budget developments should be tolerated, ie the automatic stabilisers should be allowed to take effect. Overall, German fiscal policy is making an important contribution to stabilising the situation in the euro area, although more resolute efforts could be made towards strengthening growth potential within the current budgetary framework. By contrast, little would be gained from launching a debt-financed demand stimulus in Germany, given the largely neutral domestic economic situation and an only limited impact on the rest of the euro area.

Budgetary development of central, state and local government

Tax revenue

Further robust growth in tax revenue in 2014

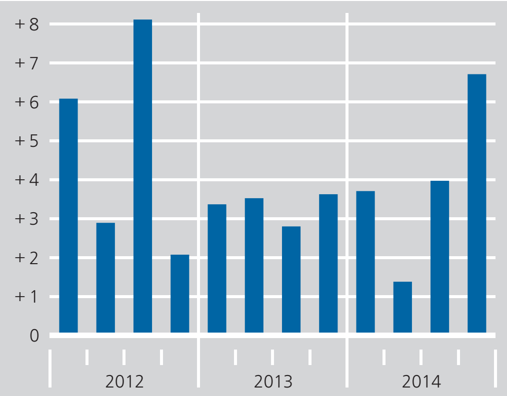
At 4%, growth in tax revenue[2] remained stable in 2014 (see the chart and table on pages 64 and 65) and was therefore somewhat higher than predicted in the November forecast made by the Working Party on Tax Revenue Forecasting. Receipts from income-related taxes climbed significantly by just over 5%. This was chiefly due to the dynamic increase in wage tax receipts which, although bolstered by stagnating deductions (for child benefit and subsidies for supplementary private pension plans), was mainly attributable to positive wage developments and the growing number of employed persons. Despite the basic income tax allowance being raised, the progressive taxation schedule also contributed to the increase. By contrast, at 3½%, the rise in receipts from profit-related taxes decelerated significantly. Growth in assessed income tax maintained a

Buoyant growth in wage tax receipts

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

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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strong upward trajectory, which was partly attributable to the development of deductions (a much weaker rise in income tax refunds to employees and the phasing-out of both the homebuyers' grant and the investment grant) but also reflects solid growth in gross revenue. However, following strong growth in previous years, the increase in revenue from corporation tax slowed down in 2014, with receipts from non-assessed taxes on earnings (primarily investment income tax on dividends) edging up only slightly. Receipts from withholding tax on interest income and capital gains actually decreased considerably, not least on account of the lower average annual interest rate. Overall, receipts from consumption-related taxes increased at a below-average pace of just over 2½%. Stagnating energy and electricity tax receipts (probably due in part to weather conditions) were a contributing factor here, while receipts from turnover tax grew in line with the relevant macroeconomic reference variables.

Below-average rise in receipts from consumption-related taxes

Revenue growth expected to continue on stable path in 2015

According to the latest official tax estimate, at 3%, growth in tax revenue (including local government taxes) is expected to shrink slightly in 2015. The underlying growth in macroeconomic reference variables for tax revenue is forecast to be roughly the same as in 2014 and legislative changes are likely to be relatively insignificant. However, tax refunds are expected as a result of previous court rulings.[3]

Central government budget

No net borrowing in 2014 thanks to end of exceptional charges, rising tax revenue and declining interest payments

Central government was able to close the 2014 fiscal year without posting any net borrowing, ie with a balanced budget,[4] for the first time since 1969 and one year earlier than planned, after it had recorded net new borrowing of €22 billion in 2013. On the expenditure side, reduced exceptional charges were the main factor behind the improvement (elimination of advance payments to the flood assistance fund of €8 billion and a €4½ billion cut in ESM contributions). In addition, the interest burden fell sharply (-€5½ billion). All in all, central government expenditure fell by 3½% (€12½ billion). By contrast, growth of 3% (€9½ billion) was recorded on the revenue side. Tax revenue increased significantly (+€11 billion). The Bundesbank's profit distribution for the core budget also rose by €2 billion. By contrast, the €3 billion decrease in proceeds from asset realisations placed a strain on the budget.

Result significantly better than forecast

Overall, the fiscal balance was €6½ billion higher relative to the budget estimates drawn up in June 2014. Receipts were €5½ billion higher than forecast, with tax revenue exceeding budget estimates by €2½ billion. Non-tax receipts were €3 billion higher than estimated, not least owing to the fact that provisions of €1½ billion in the budget for any shortfalls due to court rulings regarding the constitutionally still controversial nuclear fuel tax did not need to be drawn upon. The sum of well-specified estimates on the expenditure side was undershot by a total of €3 billion, thus exceeding the global cuts in expenditure provided for in the budget plan. The largest savings were made on

3 Chiefly the European Court of Justice ruling of 20 October 2011 on the taxation of dividends paid to EU/EEA companies, with total losses of €2½ billion distributed over the course of 2015 and 2016 (case C-284/09).
4 However, the fiscal balance excluding coin seigniorage was slightly negative.

Tax revenue

Type of tax	Year as a whole				Estimate for 2014 as a whole[1,2,3]	Q4			
	2013	2014				2013	2014		
	€ billion		Year-on-year change € billion	%	Year-on-year change %	€ billion		Year-on-year change € billion	%
Tax revenue, total[2]	570.2	593.0	+ 22.8	+ 4.0	+ 3.5	153.8	164.1	+ 10.3	+ 6.7
of which									
Wage tax	158.2	168.0	+ 9.8	+ 6.2	+ 6.1	44.9	47.6	+ 2.7	+ 6.1
Profit-related taxes[4]	87.7	90.9	+ 3.2	+ 3.6	+ 1.0	19.9	22.2	+ 2.3	+ 11.4
Assessed income tax	42.3	45.6	+ 3.3	+ 7.9	+ 5.8	10.6	11.8	+ 1.2	+ 11.2
Corporation tax	19.5	20.0	+ 0.5	+ 2.7	− 1.2	4.8	5.1	+ 0.3	+ 6.2
Investment income tax[5]	25.9	25.2	− 0.7	− 2.7	− 5.3	4.6	5.3	+ 0.8	+ 17.5
Turnover taxes[6]	196.8	203.1	+ 6.3	+ 3.2	+ 3.1	50.5	52.3	+ 1.8	+ 3.5
Energy tax	39.4	39.8	+ 0.4	+ 1.0	+ 1.4	15.1	15.2	+ 0.1	+ 0.4
Tobacco tax	13.8	14.6	+ 0.8	+ 5.7	+ 4.7	4.3	4.7	+ 0.4	+ 8.7

Sources: Federal Ministry of Finance and Bundesbank calculations. **1** According to official tax estimate of November 2014. **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 €3.7 billion above the May 2014 estimate, which formed the basis for the 2014 central government plan drawn up in summer 2014. Excluding the effect of legislative changes made since the estimate, the government projects that tax revenue would have been revised upwards by €3.6 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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interest expenditure (€1½ billion). Outflows of funds for investment remained €½ billion below their estimates, not least on account of lower payments to Deutsche Bahn (the German railway company) and the smaller number of development aid loans granted.

Structural balance in 2014 also far more positive than estimated

Based on initial national accounts figures from the Federal Statistical Office in accordance with the debt brake provisions for central government, the Ministry of Finance disclosed a structural surplus of 0.3% of GDP in its monthly report for January 2015.[5] This equates to an improvement of 0.2 percentage point on the budget estimate.[6] While the Bundesbank's cyclical adjustment procedure results in a significantly lower cyclical burden for 2014, after deduction, a structural surplus of 0.1% of GDP is still recorded even on this basis. Overall, the achievement of a safety margin vis-à-vis the permanent upper limit of 0.35% of GDP for structural net borrowing to be observed as of 2016 is welcome.

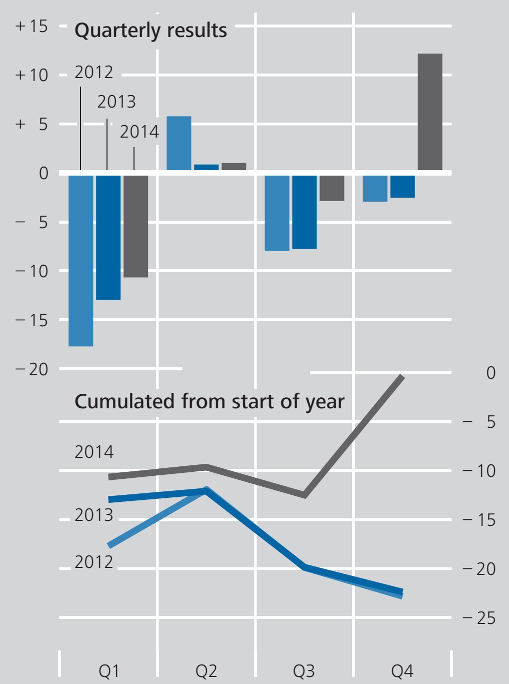
Improved starting point but also risks for 2015 budget

While the 2015 budget, which was approved at the end of November and envisages no net borrowing, does not foresee any further improvement in the balance compared with the actual 2014 figures, several of the positive budget deviations in 2014 are likely to extend into this year. For example, it is expected that the favourable 2014 result will largely continue to serve as a base effect for tax revenue. Furthermore, the German economy's now somewhat more favourable growth prospects could additionally boost tax receipts. The persistently low interest rate level could also provide further

5 The surplus factors in the combined €1 billion deficit of the Energy and Climate Fund and the flood assistance fund (central government off-budget entities) while deducting cyclical burdens of €6 billion and net expenditure on financial transactions totalling €2½ billion.
6 It should be noted that the flood assistance fund was included in the budget plan with a zero deficit despite the alleviating effect of the planned (but not yet completed) transfer of €1 billion back from the flood assistance fund having been factored into the central government budget. The structural surplus reported in the budget plan was therefore too high.

Central government fiscal balance*

€ billion



Source: Bundesbank calculations based on data from the Federal Ministry of Finance. * Core budget excluding off-budget entities. Not adjusted for financial transactions or cyclical effects.

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relief relative to budget estimates. Additionally, it appears that revenue from the radio frequency auction planned for 2015 was not factored into the budget.[7] However, this more favourable outlook for the budget should not be misinterpreted as creating scope for fiscal manoeuvre. Ballooning demographic burdens and rising interest rates are likely for the central government budget in the longer term. Moreover, considerable risks exist in the relatively short term arising from guarantees given by Germany for assistance loans to euro-area member states and rulings yet to be made by the Federal Constitutional Court, in particular, concerning nuclear fuel tax and the phasing-out of nuclear energy.

Benchmark figures for coming years should take account of risks and seek value for money from investment

It seems appropriate for these considerations to also be taken into account in mid-March when central government sets out benchmark figures for the 2016 budget and the medium-term fiscal plan up to 2019. Increased central government investment in the 2016 to 2018 period to the cumulated amount of €10 billion with no net borrowing, which was announced back in November 2014, is expected to be offset primarily by additional interest cost savings. Germany was called upon by, among others, the European Commission and international organisations to boost government investment spending. Attention has been focused on numerous comparisons of Germany's expenditure with that of other countries. However, it is not possible to deduce in this manner whether Germany needs to increase government investment spending. For example, expenditure comparisons can be distorted due to responsibilities being divided differently between the public and private sector and due to the inefficient allocation of funds. When making comparisons over time, events such as the surge in investment in the wake of German reunification, which are ultimately followed by a period of normalisation, need to be taken into account. In any event, it is important to first critically check the benefits to be expected from each project. It should also be ensured that investment expenditure, including follow-up costs, is realistically estimated at the cost efficiency analysis stage and that systematic use is made of cost-cutting opportunities in planning, construction and operation. Greater involvement of private investors would likely be of little benefit with respect to financing costs. If financing were provided outside the central government budget, there would also be a risk of circumventing the debt brake. In any case, it appears that no additional central government borrowing is required to maintain a good infrastructure.

Central government's off-budget entities (excluding bad banks and the loss compensation payments they receive) recorded a surplus of around €4 billion in 2014 compared with €11

7 The total minimum bids are reported to amount to €1½ billion. However, it seems to have already been agreed to make compensation payments to those who previously used the frequencies, give federal states a share in the income and make funds available to expand the network, meaning that net relief for the 2015 central government budget could be moderate.

Surplus for off-budget entities in 2014 weaker but still marked thanks to Bundesbank profit

billion in 2013. The decrease mainly reflects the elimination of central government payments totalling €8 billion to the flood assistance fund (with only a small increase in expenditure by the flood assistance fund). But the Financial Market Stabilisation Fund (SoFFin) also recorded a decline after posting a surplus of €1½ billion following repayment of the final tranche of its silent participation in Commerzbank in 2013. By contrast, the Investment and Repayment Fund closed €2 billion higher after receiving this level of funds from the Bundesbank's profit distribution. Lower profit distribution by the Bundesbank and higher outflows from the flood assistance fund could place a strain on the surplus for off-budget entities in 2015 compared with the previous year. Overall, however, sustained surpluses, especially that of the precautionary special funds for civil servant pensions, could at the very least offset anticipated deficits, chiefly in the flood assistance fund.

State government budgets[8]

Surplus in 2014 primarily due to growth in tax revenue

According to the monthly cash statistics, in 2014 state government core budgets recorded a surplus (of just over €½ billion) for the first time since 2008, following a deficit of €½ billion one year previously. Revenue rose by 4% (€12½ billion). This was ultimately mainly due to growth in tax revenue (+4½%, or €10 billion), with joint taxes and, in particular, inheritance tax and real estate acquisition tax (the figure for the latter was also impacted by tax rate increases) rising significantly. Furthermore, in the last quarter BayernLB made a large-scale payment in connection with support measures from the federal state of Bavaria.[9] By contrast, transfers received from public administrations increased at a more moderate pace (+2½%, or €1½ billion). Expenditure (+3½%, or €11½ billion) recorded somewhat weaker growth than revenue. Once again, significantly higher current transfers to local government (+6½%, or €4½ billion) were a particularly major factor in this regard. Moreover, in light of wage adjustments also being applied to civil servants and retired civil servants,[10] personnel expenditure rose considerably (+3½%, or €4 billion). Investment expenditure also recorded marked growth (+3%, or €1 billion), while other operating expenditure stagnated and interest expenditure recorded a significant decline (-8%, or €1½ billion).

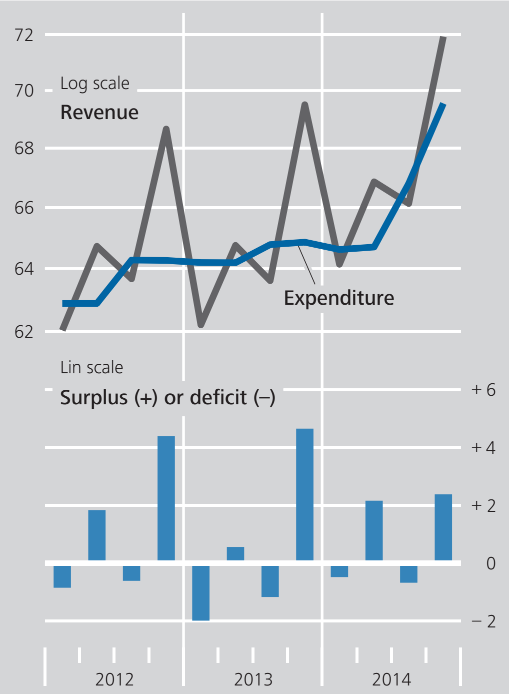
Stability Council warns Bremen, in particular, but also Saarland of further need for consolidation

In 2014, most of the federal states (Baden-Württemberg, Bavaria, Berlin, Hamburg and the east German states) recorded core budget surpluses. However, despite some improvement, Bremen and Saarland still recorded very high deficits per capita, and Rhineland-Palatinate, Hesse, North Rhine-Westphalia and Schleswig-Holstein also recorded marked deficits. Based on the assumed ongoing favourable conditions and increasing relief being provided by central government, in December 2014 the Stability Council forecast steady – although given the overall positive budgetary situation only minor – improvements in the budgetary balance for state government as a whole for subsequent years. Developments in the federal states of Berlin and Schleswig-Holstein, where budgetary recovery procedures were initiated, were given a positive assessment. By contrast, the measures announced by Bremen were criticised and deemed insufficient, and the Stability Council once again called on the federal state to step up its consolidation efforts. Given a dwindling and comparatively low safety margin vis-à-vis the upper limit within the framework of the agreed deficit reduction path, Saarland was also called on to

8 The development of local government finances in the third quarter of 2014 was analysed in the short articles of the Bundesbank's January 2015 Monthly Report. These are the most recent data available.
9 BayernLB made a payment of almost €2 billion to the Bavarian state government in connection with the sale of an ABS portfolio and the repayment of a further part of the silent participation. In return, the Bavarian state government paid €1 billion to BayernLB owing to a loss compensation guarantee.
10 Another factor in this regard was that in North Rhine-Westphalia the increased remuneration and pension payments for higher pay grades which were agreed retrospectively (following a ruling by the State Constitutional Court) were paid out in the final quarter. A similar adjustment was made in Bremen.

Finances of the German statutory pension insurance scheme

€ billion, quarterly data



Source: German statutory pension insurance scheme (Deutsche Rentenversicherung Bund).
Deutsche Bundesbank

continue to push ahead with its budgetary consolidation measures. In these two federal states, the budget plans still envisage marked deficits, which is also attributable to the fact that the very favourable conditions have not been consistently used to achieve more rapid consolidation. There is thus still a considerable need for consolidation.

Saxony-Anhalt and Thuringia also still need to make sizeable adjustments to comply with debt brake

A study[11] published alongside the statement of the Advisory Board of the Stability Council points to considerable differences in the scope for expenditure of individual federal states (including local governments and off-budget entities) if they are to achieve a balanced budget in 2020 when the debt brake enters into full force. According to the study, given the developments in tax revenue currently forecast, and after deducting interest and pension expenditure extrapolated based on standard assumptions,[12] numerous federal states would be able to cope with marked increases in expenditure. Bremen, which is heavily indebted, would also be able to put up expenditure to a limited extent, whereas Saarland would have to reduce its expenditure each year even if interest rate conditions were favourable and pension expenditure developed at a more subdued pace (compared with the baseline scenario). Some of the east German states also face major challenges, even though they currently have budgetary surpluses, as the financial assistance payments provided to rebuild eastern Germany will be phased out by 2020 and a further marked decline in the population is expected. The projected figures for the real scope for expenditure (ie after adjustment for price changes) show that in addition to Saarland and Bremen, there is also a distinct need for spending cuts in Saxony-Anhalt and Thuringia.

Social security funds[13]

Statutory pension insurance scheme

Unexpectedly high surplus in 2014

According to preliminary data, the statutory pension insurance scheme recorded a clear surplus of just over €3 billion in 2014. On balance, the additional revenue owing to the contribution rate cut being waived at the start of 2014 (although the cut was generally required by law) outweighed the additional expenditure from mid-2014 onwards resulting from the pension benefits package (in particular,

11 See I Deubel, J Hamker, D Rumpf and D Stegarescu (2014), Zum Ausgabenspielraum der einzelnen Bundesländer im Rahmen der Schuldenbremse bis zum Jahr 2020, mimeo, www.stabilitaetsrat.de. The Advisory Board of the Stability Council refers in detail to the study in its statement dated 8 December 2014 on compliance with the upper limit for the structural general government deficit (see pp 17-24).
12 To calculate the actual available scope for expenditure, interest and pension expenditure are deducted from the available funds (tax revenue after financial equalisation plus transfers from central government and the EU), since they represent non-disposable or less-disposable existing burdens.
13 The financial development of the statutory health and public long-term care insurance schemes in the third quarter of 2014 was analysed in detail in the short articles of the Bundesbank's December 2014 Monthly Report. These are the most recent data available.

mothers' pension and full pension at 63). The surplus was up by €1 billion on the year. Overall, revenue rose by 3½%, whereas expenditure increased by 3%. Contribution receipts benefited from the ongoing favourable employment and wage developments. At almost 4%, they rose at a greater pace than total receipts because other components, such as central government grants in particular, recorded weaker growth. In addition to the general adjustment requirements, a further €¼ billion discretionary cut in the general central government grant contributed to the weaker growth.

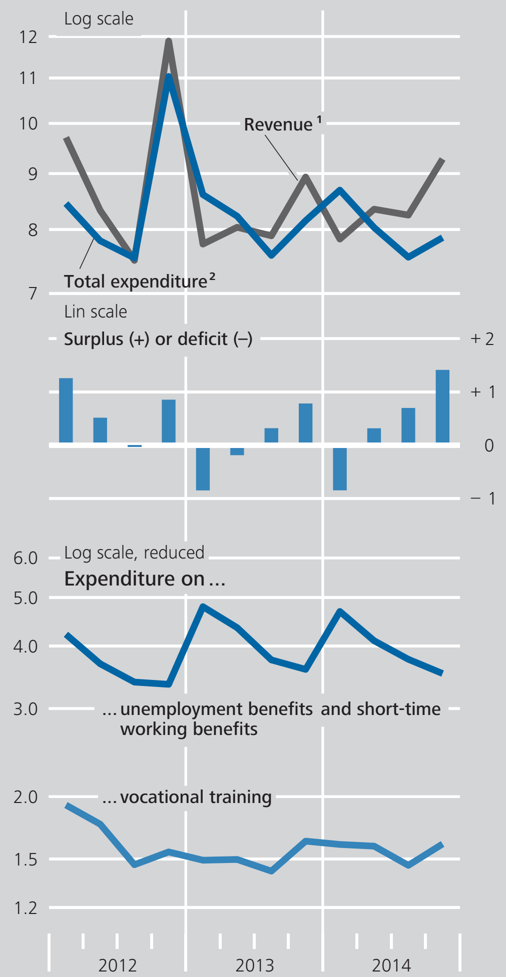
Expenditure growth so far below estimates for pension benefits package

Pension expenditure developed very differently in the two halves of the year. In the first six months, it still recorded very moderate year-on-year growth of just over ½%, which was attributable to the low mid-2013 pension increase, the scheduled increase in the official retirement age and the still relatively small number of people in the age groups currently entering retirement. The mid-2014 pension increase was higher (1.67% in western Germany and 2.53% in eastern Germany). However, the acceleration in expenditure growth was mainly due to the expanded benefits for periods spent raising children born before 1992 and the full pension without actuarial deductions from the age of 63 for persons who have been insured for a particularly long period of time. In the second half of the year, expenditure rose at a significantly faster pace (just over 5%). Nevertheless, the additional expenditure lagged behind the amount estimated in the draft Act on Improvements in Pension Insurance Benefits *(Rentenversicherungs-Leistungsverbesserungsgesetz)*. It is so far not clear to what extent this is due, for example, to a lower-than-expected take-up for the full pension at 63, or whether statutory pension insurance institutions are still processing applications which will not be completed until during the course of this year but will ultimately be assigned to the 2014 accounts.

The actual financial impact of the pension benefits package will also affect the projected outlook for the current year. If expenditure

Finances of the Federal Employment Agency

€ billion, quarterly data



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

growth really is weaker than forecast by legislators, the reserves – which accrued to 1.9 times the scheme's monthly expenditure at the end of 2014 – might decline at a slower pace in 2015 than assumed by the Federal Government in its most recent report on the statutory pension insurance scheme, for example. The contribution rate for 2016 would then have to be lowered so that at the end of 2016 the reserves would no longer exceed the upper limit of 1.5 times the scheme's monthly expenditure.

Contribution rate cut possible again in 2016 given ongoing favourable developments

Federal Employment Agency

Clear surplus in 2014 …

The Federal Employment Agency (including civil servant pension funds) recorded a €2 billion surplus at the end of 2014, which was also better than expected. This constitutes a year-on-year improvement of €1½ billion. Although it had long been evident that the surplus would be higher than the figure estimated in the budget plan (€¼ billion), spending on active labour market policy measures as well as on short-time working benefits and insolvency benefit payments was even lower than expected. Contributions recorded a steep increase of 4% on the year owing to favourable employment and wage developments. Overall, revenue increased at a somewhat weaker pace (just under 3½%) because central government refunds for excess reintegration payments were made for the last time in 2013. On the expenditure side, payments for unemployment insurance benefit (I) remained virtually unchanged on the year. While the number of recipients fell by around 2½%, per capita payments increased at about the same pace. Short-time working benefits and insolvency benefit payments recorded significant declines, while spending on active labour market policy measures rose slightly for the first time since the crisis year of 2009. Overall, expenditure decreased by just under 1½%.

… and probably also in 2015

The Federal Employment Agency's budget plan envisages a decline in the surplus to just under €½ billion in 2015. However, the estimates for spending on active labour market policy measures and on short-time working benefits and insolvency benefit payments seem to be significantly overstated in light of the 2014 results, which are now available, and the current economic outlook. Overall, as things stand today, a higher surplus is likely to be recorded for 2015.