Public finances*

General government budget

Rise in surplus in 2015 due to temporary factors and …

German public finances are continuing to develop favourably in 2015. The surplus is likely to once again be up on the year (2014: 0.3% of gross domestic product (GDP)), although this is mainly attributable to temporary factors. Whereas court decisions temporarily had a negative impact on the 2014 fiscal balance, inflows of funds from the auction of radio frequencies are having a positive effect this year.[1] By contrast, the impact of cyclical factors on the government budgets remains limited. Overall, in structural terms, the surplus could therefore amount to around ½% of GDP, as in the previous year. The revenue ratio, which is broadly stable, is being accompanied by a continued decline in the interest burden, on the one hand, but a relatively strong rise in other spending, on the other. The reasons for this include not only the strong rise in the number of refugees coming to Germany, particularly in the second half of the year, but also the pension benefits package that came into force in mid-2014.

… debt ratio falling

The debt ratio fell further during the first half of the year – from 74.9% at the end of 2014[2] to 72.5% in mid-2015 – and this decline is set to continue. This was attributable to nominal GDP growth in the ratio's denominator as well as a lower level of gross debt in the core budgets and a scaling-back of liabilities at government-owned bad banks – although, in the case of said liabilities, developments may be subject to stronger fluctuations, irrespective of the portfolio reduction outlined here.

Contraction of surplus in 2016

The surplus is expected to contract in 2016. As a result, the government budget could be more or less balanced, with the debt ratio continuing to fall. While positive cyclical developments and a further drop in interest expenditure could relieve budgets, no auction proceeds will be collected and various fiscal policy measures (tax cuts and additional expenditure on items such as infrastructure, education and research) will place a strain on public finances. In particular, the increase in expenditure related to the influx of refugees will have an impact.

Considerable uncertainty regarding refugee influx

However, it is very hard at present to gauge how the migration of refugees and the associated implications for public finances will pan out.[3] Generally speaking, the impact on the budgets crucially hinges, first of all, on net immigration. In this regard, it is not only the number of persons entering the country but also the number leaving – for example, owing to their asylum applications being rejected – that plays a role. Second, the burdens for a given year depend on the annual average number of refugees that need to be provided for. For example, there has been a sharp rise in immigration this year, but the resulting fiscal burdens are still fairly limited as this development has predominantly taken place during the second half of the year. Third, the specific amount of spending on individual immigrants is of significance. Expenditure will fundamentally focus on basic needs (including accommodation and

---

* 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 Temporary burdens of 0.3% of GDP were recorded in 2014. These were due to expected tax refunds, which were reported as capital transfers in the national accounts at the time of the court ruling. The inflows of funds from the auction held by the Federal Network Agency in spring 2015 amount to 0.2% of GDP.
2 As part of the 2015 autumn notification, the debt ratio was revised upwards by a total of 0.2 percentage point compared with the spring notification. Recording central government liabilities to KfW (Kreditanstalt für Wiederaufbau) in connection with student grants and loans, including further government-initiated transactions and reclassifying entities at local government level pushed up the ratio by 0.5 percentage point. Conversely, the upward revision of GDP lowered the ratio by 0.3 percentage point.
3 However, there is also uncertainty surrounding factors such as macroeconomic developments or, for instance, the specific impact of the measures announced by HSH Nordbank.

healthcare),[4] administration, childcare, education and training. In the long term, the better and more quickly immigrants are integrated into the labour market, in particular, and earning their own income, the lower the burden on public finances will be. If it is likely that an immigrant will remain in Germany in the long term, it will be crucial for them to be effectively integrated into the labour market – the acquisition of German language skills and the training opportunities provided by schools and enterprises will be significant factors in this respect. The government has a role to play here, especially with regard to ensuring efficient cooperation between public sector entities. It is extremely difficult to make any estimates at the moment, not least given the uncertainty surrounding future immigrant numbers. At present, additional government expenditure in the amount of up to ¼% of GDP this year and ½% for the year ahead does not seem implausible.[5] Additional receipts from taxes and social contributions paid by immigrants can initially be expected to be very limited.

Safety margins allow unexpected budgetary burdens to be accommodated without exceeding limits

The current situation demonstrates the advantage of having a relatively favourable structural budgetary situation and safety margins to the limits set by European and national budgetary rules. Not least unexpected developments and additional burdens that are difficult to gauge can initially be absorbed in the budgets without immediately having to take fiscal policy countermeasures or call into question the credibility of the rules by bending them.[6] At this stage, the burdens in connection with the influx of refugees, which can only be roughly estimated at best, could initially be cushioned without counterfinancing, thereby narrowing the safety margins.

In principle, moderate structural surpluses for Germany appropriate

Greater clarity regarding the continued influx of refugees, the direct budgetary impact and political decisions in Germany and also in the European Union, as well as the resulting overall impact on government finances, may be expected going forward. Structural burdens – because, for example, it takes a long time to integrate the large number of immigrants into the labour market – should then be taken into account in future budget plans and counterfinanced. A moderate structural budget surplus for Germany is advisable not only to ensure compliance with the upper deficit limits. It would also be a good idea to continue reducing the still high debt ratio swiftly, not least because this would effectively cap the interest burden in the long term – especially given the possibility of interest rates going back up in the future. This results in additional scope for manoeuvre, which could be used to address the fiscal policy challenges posed by unfavourable demographic developments, for instance. Sound public finances are not antithetical to tackling immigration, among other challenges, or to improving infrastructure and government educational programmes. Instead, they are precisely a key prerequisite for continuing to be able to cope with unexpected challenges in the future.

4 Cash payments and benefits in kind are granted pursuant to the Act on Benefits Granted to Persons Seeking Asylum (Asylbewerberleistungsgesetz), particularly while applications are being processed and, if an application is rejected, until the person concerned has left the country. If the applicant is granted refugee status, for example, the regular social security system will ultimately assume responsibility for payments. If the need arises, the person concerned is then entitled, for instance, to claim unemployment benefit II (welfare-related benefit) and have accommodation costs refunded.
5 Owing to the uncertainties, the German Council of Economic Experts, for example, has calculated the expected costs for various scenarios, resulting in estimates for additional expenditure ranging between €3½ billion and €6 billion in 2015 and €6½ billion up to €12 billion in 2016. See German Council of Economic Experts, Zukunftsfähigkeit in den Mittelpunkt, Jahresgutachten 2015/16, pp 16 f.
6 Generally speaking, this also applies to surprises such as those relating to macroeconomic developments. For example, identifying trends in key macroeconomic reference variables (or in potential output), which are factored into the estimation of the structural budgetary situation, is, as a general rule, fraught with uncertainty. After the Federal Government had previously regularly reported a distinct underutilisation at the current end, it recently projected – following a reassessment – that the output gap will be more or less closed in 2016, which seems more plausible. Consequently, the structural budget balance is now less favourable. If a safety margin had not been factored in, this revision would, in and of itself, have made it necessary to take consolidation measures in the short term to comply with the structural budget ceilings.

At most temporary deviations from fiscal limits compatible with European rules' objectives

In the context of the Stability and Growth Pact, the European Commission announced that it would make concessions when assessing compliance with the rules regarding the additional financial burden associated with the influx of refugees. Non-compliance would be justifiable only if this development could be classified as unexpected and meant that fiscal rules were bent merely on a short-term and temporary basis due to no more than specifically documented direct net additional burdens. A further option potentially on the table – factoring out, on a longer-term basis, any additional refugee-related burdens – would, however, not be consistent with the Pact's aim of ensuring sound public finances. A structural public spending requirement therefore ought to be covered by corresponding income so as to keep government debt at a comfortably sustainable level. This does not mean that tasks considered to be important cannot be carried out, but that these should be financed in a sustainable manner.

Fiscal fine-tuning at European level not convincing

With regard to the orientation of public finances in the euro area as a whole, there have been calls from some quarters for countries that have built in safety margins below the European deficit limits – this applies to Germany, in particular – to make use of this leeway and adopt a more expansionary fiscal policy stance, thereby steering overall demand in the euro area. However such a recommendation, which amounts to centralised fiscal policy (fine-)tuning for the euro area, is not convincing. Under the existing regulatory framework of European monetary union, member states are responsible for their own national fiscal policies and have agreed to comply with the upper limits of the common budgetary rules. The automatic stabilisers can take effect and there is scope for the respective countries to pursue active fiscal policies provided they do not exceed the prescribed limits. This means that fiscal policy can take into account country-specific macroeconomic developments, while monetary policy pursues its objective of price stability in a centralised manner, looking at the euro area as a whole. Macroeconomic fine-tuning is extremely difficult, even for an individual country, and attempts to achieve this in the past have often had unintended procyclical consequences owing to diagnostic and implementation problems. A symmetrically more restrictive stance in good times – as would be required under a systematic stabilisation policy, but also to avoid unintended debt growth – has also often been unsuccessful. Looking at the European level as a whole, it seems that it would be worth considering a coordinated approach on an exceptional basis, at best, if there was a threat of an extensive crisis – such as a self-reinforcing deflationary spiral – which even monetary policy can do little to tackle. However, this is currently not the case. Fine-tuning attempts at the European level using fiscal policy instruments are therefore not advisable. It does not seem appropriate, for example, to put fiscal policy in Germany on a more expansionary course – disregarding the rather favourable economic outlook – in order to indirectly stimulate demand in other euro-area countries, as this would amount to a U-turn on Germany's basic position, which is generally considered sensible. It is likely that the scale of the fiscal loosening being contemplated would, in any case, have only a comparatively minor impact on demand.

Sustainability of public finances not focus of proposed European Fiscal Board

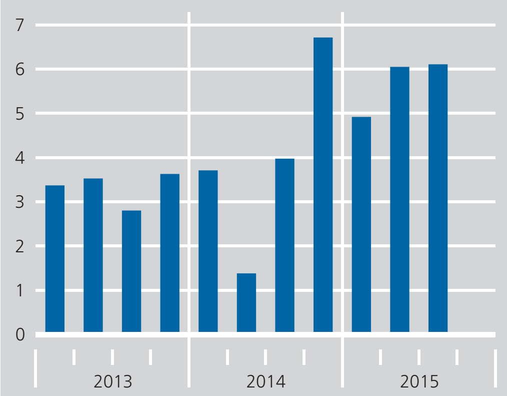
Against this backdrop, the mandate of the European Fiscal Board – the latter was recently agreed on by the European Commission – should be viewed in a critical light. This Board, set up within the European Commission, has not only been given the task of evaluating on the Commission's behalf whether the Stability and Growth Pact has been appropriately implemented but also of providing an assessment of what it considers a suitable fiscal stance for the euro area as a whole going forward. This is another example of the Stability and Growth Pact, with its objective of sound public finances, being merged with macroeconomic governance. Consequently, there is a risk of the goal of sound public finances being pushed into the background. By contrast, a welcome development would be the establishment of an independent European fiscal council outside the European Commission that has the sole specific task of budgetary surveillance in the sense of monitoring compliance with the rules, and would assume the European Commission's tasks in this respect.[7] This would mean that, while the Ecofin Council would still make the final decisions, a clearer process focusing on sound public finances could be created.

Budgetary development of central, state and local government

Tax revenue

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.

Deutsche Bundesbank

Further considerable growth in tax revenue in 2015 Q3

Tax revenue[8] in the third quarter of 2015 was up by 6% on the year. The growth in receipts recorded during the first six months of the year was therefore maintained (see the chart above and the table on page 62). Wage tax revenue continued to record strong growth, but this was somewhat weaker than in the first half of the year. At 12%, revenue from profit-related taxes rose sharply. This was, however, partly due to intra-year payment deferrals for non-assessed taxes on earnings. Receipts from consumption-related taxes recorded somewhat stronger growth than they had done of late, rising by 3%.

Revenue growth for year as a whole mainly reflects macroeconomic developments

According to the latest official tax estimate, tax revenue (including local government taxes) is forecast to rise by 4½% for the year as a whole. This growth primarily reflects underlying macroeconomic developments[9] as well as the positive effects of fiscal drag.[10] Legislative changes are causing small-scale revenue shortfalls on balance. These shortfalls are attributable, in particular, to the gradual changeover to downstream taxation of pensions and the rise in child benefit, which is deducted from wage tax revenue. By contrast, the increases in real estate acquisition tax, which were implemented in some federal states at the start and in the middle of 2015, have bolstered receipts. Furthermore, marked shortfalls were assumed for corporation tax, local business tax and turnover tax, in particular, as a result of court rulings.[11]

Subdued growth in 2016 …

In 2016, tax revenue is expected to rise at a subdued pace of only 2%. Although growth in macroeconomic reference variables for tax revenue is forecast to be roughly the same as in

7 For more information, see Deutsche Bundesbank, Approaches to strengthening the regulatory framework of European monetary union, Monthly Report, March 2015, pp 15-37.
8 Including transfers to the EU budget – which are deducted from German tax revenue – but excluding receipts from local government taxes, which are not yet known for the quarter under review.
9 This estimate is based on central government's current macroeconomic projection. For 2015, real GDP growth is expected to be 1.7% and nominal growth 4.0% (May: +1.8% and +3.8%, respectively). GDP growth for 2016 is forecast to be 1.8% in real terms and 3.4% in nominal terms (May: +1.8% and +3.3%, respectively). For 2017, GDP growth is estimated to be 1.5% in real terms and 3.3% in nominal terms (May: +1.3% and +3.2%, respectively). In the medium term, nominal growth of around 3% per annum is still forecast.
10 In this context, the term "fiscal drag" denotes 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.
11 For 2015, this predominantly relates to the rulings by the Federal Fiscal Court of 25 June 2014 (I R 33/09) and of 30 July 2014 (I R 74/12) on section 40a of the Act on Asset Management Companies (Gesetz über Kapitalanlagegesellschaften) and STEKO (section 8b (3) of the Corporation Tax Act (Körperschaftsteuergesetz)) (see also Bundestags-Drucksache 18/5560). In the national accounts, the impact of these rulings pushed up expenditure in 2014. Furthermore, shortfalls in turnover tax revenue are expected. The impact of these rulings was taken into account in the national accounts in 2013 and 2014.

Tax revenue

Type of tax	Q1 to Q3 2014 € billion	Q1 to Q3 2015 € billion	Q1 to Q3 2015 Year-on-year change € billion	Q1 to Q3 2015 Year-on-year change %	Estimate for 2015[1,2] Year-on-year change %	Q3 2014 € billion	Q3 2015 € billion	Q3 2015 Year-on-year change € billion	Q3 2015 Year-on-year change %
Tax revenue, total[2]	428.9	453.4	+ 24.5	+ 5.7	+ 4.5	144.5	153.3	+ 8.8	+ 6.1
of which									
Wage tax	120.3	129.1	+ 8.7	+ 7.3	+ 6.6	40.5	43.3	+ 2.7	+ 6.7
Profit-related taxes[3]	68.7	72.9	+ 4.2	+ 6.1	+ 4.2	20.3	22.8	+ 2.5	+ 12.1
Assessed income tax	33.8	36.1	+ 2.3	+ 6.9	+ 6.7	10.0	10.7	+ 0.6	+ 6.4
Corporation tax	15.0	15.7	+ 0.7	+ 5.0	+ 4.6	4.3	4.5	+ 0.1	+ 3.2
Investment income tax[4]	19.9	21.0	+ 1.1	+ 5.7	− 0.4	6.0	7.6	+ 1.7	+ 28.1
Turnover taxes[5]	150.8	155.8	+ 5.0	+ 3.3	+ 3.1	51.1	53.2	+ 2.1	+ 4.0
Energy tax	24.6	24.4	− 0.2	− 0.8	+ 0.2	10.0	10.2	+ 0.1	+ 1.3
Tobacco tax	9.9	9.9	− 0.0	− 0.3	+ 0.2	3.7	4.0	+ 0.2	+ 6.6

Sources: Federal Ministry of Finance and Bundesbank calculations. **1** According to official tax estimate of November 2015. **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

2015, this is outweighed by the dampening impact of legislative changes and court rulings on revenue growth. With regard to legislative changes, the measures to provide income tax relief passed in summer 2015 (increases in tax allowances and child benefit as well as a rightward shift in the income tax rates) will lead to revenue shortfalls. With respect to court rulings, some of which were made some time ago, tax refunds are expected to be significantly higher overall than in 2015.[12] The dampening impact of the court rulings will then largely no longer apply in 2017. This situation and the assumption of a sound macroeconomic setting mean that revenue growth is expected to be considerable again, at 4½%, in 2017. Average annual increases of 3½% are forecast for 2018 to 2020. Developments will then primarily be determined by macroeconomic growth assumptions and fiscal drag, the effect of which significantly outweighs the relief provided by the changeover to downstream taxation of pensions. The tax ratio (as defined in the government's financial statistics) is therefore projected to increase to 22.4% by the end of the forecast period in 2020 (2014: 22.1%).

… and increases expected to be somewhat sharper again in subsequent years

Revenue expectations raised for 2015 but revised downwards for 2016

The May forecast has thus been revised upwards considerably for 2015 (+€5 billion). This is mainly attributable to tax revenue so far having developed more favourably than expected in terms of cash receipts. This is also set to continue, to some extent, in the years to come. The somewhat more favourable macroeconomic setting compared with the May estimate also results in a slight upward revision in and of itself. In 2016, these effects will, however, be more than offset by the impact of the previously outlined legislative changes concerning income tax, which had not yet been included in

12 This primarily concerns the shortfalls arising from the above-mentioned court rulings pertaining to section 40a of the Act on Asset Management Companies, which are likely to be higher than in 2015. Moreover, shortfalls are expected as a result of the ruling by the European Court of Justice of 20 October 2011 on the taxation of dividends paid to EU/EEA companies (case C-284/09).

the May estimate,[13] as well as the shortfalls that are now also expected owing to court rulings. On balance, revenue expectations for 2016 were thus substantially lowered (-€5 billion). However, tax revenue is expected to be somewhat higher again from 2017,[14] with the somewhat more favourable macroeconomic assumptions and the continued extrapolation of cash receipts from the current year contributing to this. By contrast, revenue will be reduced by the cut in income tax, in particular.

Central government budget

Scarcely any deficit increase in 2015 Q3 despite pre-funding of fund to promote municipal investment

At around €3 billion, the central government budget deficit for the third quarter of 2015 recorded hardly any increase on the year. Receipts rose significantly by 4% (€3½ billion), which was solely attributable to an increase in tax revenue. Expenditure grew at a slightly higher rate of 4½%. On balance, the main reason for this was the one-off transfer of €3½ billion to the fund to promote municipal investment, which was set up in parallel with the first supplementary budget for 2015. While interest expenditure once again fell markedly (-9½%, or -€1 billion), this was offset by strong growth in other operating expenditure (particularly payments for military procurements) and an increase in transfers to state government (€½ billion each). With a year-on-year rise of 3%, no major additional expenditure has yet been incurred in connection with unemployment benefit II, which persons granted refugee status who are in need of assistance are entitled to claim and which will therefore draw on greater resources in the near future.

Draft of second supplementary budget for 2015 utilises leeway to create a reserve without posting any net borrowing

Following the deliberations of the Budget Committee in early November, the draft of a second supplementary budget also envisages no net borrowing for 2015 as a whole. Notable differences with the first supplementary budget include additional revenue from the frequency auction in June (less the associated spending authorisations) of almost €4 billion, additional tax revenue of €1 billion (after deducting central government transfers from turnover tax revenue to state government that are primarily intended to cover the higher costs of benefits for asylum seekers) and a €2 billion reduction in spending attributed to the departmental budget "Federal debt". However, these alleviating effects are now offset mainly by additional transfers of €1½ billion to the Energy and Climate Fund, additional spending of €½ billion in connection with unemployment benefit II and the allocation of €5 billion to a reserve.[15] The reserve is intended to cover additional strains placed on the central government budget in the years to come owing to the influx of refugees. The transfer to the reserve means that the 2015 fiscal year will again be closed with net borrowing of €0, ie with a balanced budget. However, the transfer has no effect on the financial balance, resulting in a surplus of just over €4½ billion.[16]

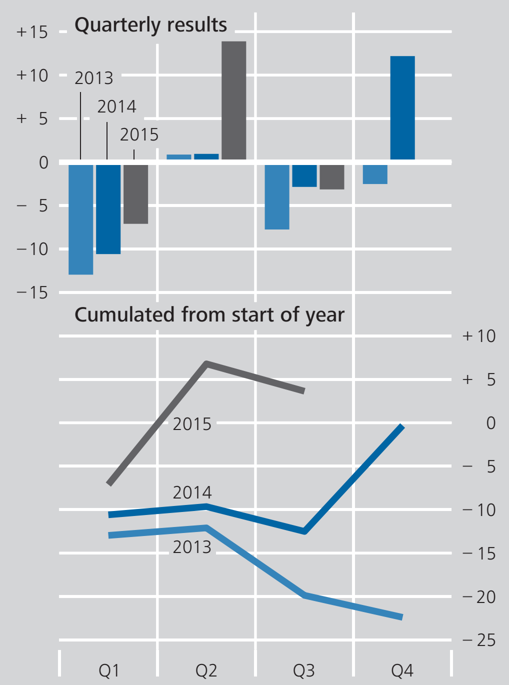
2015 debt brake requirements comfortably met

The national debt brake will limit central government's structural deficit to 0.35% of GDP (around €10 billion initially) from 2016. The Federal Ministry of Finance took into account net borrowing in its determination of the structural balance (pursuant to the draft of the second supplementary budget for 2015 as revised by the Budget Committee, ie €0). Cyclical influences (in this case, providing marginal relief)

13 The Working Party on Tax Revenue Forecasting estimates tax revenue on the basis of the current tax legislation. The changes to income tax were not adopted until after the May tax estimate had been completed.
14 Thus, revenue was raised by €2 billion in both 2017 and 2018 and by €1 billion in 2019.
15 Moreover, if the 2015 fiscal year is closed with an additional financial surplus (above the amount earmarked for the reserve), it is envisaged that the reserve will be increased accordingly. It was originally planned that any surpluses – such as an amount of €½ billion in 2014 – would not be recorded as such, but rather paid out in the form of additional expenditure to the Investment and Repayment Fund for repayment purposes.
16 The transfer to reserves mentioned is classified as an expense in main budget category 9 ("Special financing transactions"). In the absence of such a transfer, a net repayment would have to be recorded. By contrast, the budgeted transactions in main budget category 9 are excluded from the financial balance reported in the cash statistics, resulting in a surplus being recorded. In the national accounts – to which European budgetary rules are pegged – transfers to reserves (as well as financial transactions) have no effect on expenditure.

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.

Deutsche Bundesbank

and the effect of financial transactions (providing relief of €1½ billion) were then eliminated. Furthermore, individual off-budget entities that are to be consolidated were factored into the equation (no figures were estimated for them, but rather a balanced budget was assumed). As a result, the new budget plan envisages structural net borrowing of €1½ billion for 2015, which is well below the limit specified under the debt brake. If, by contrast, the surplus that the fund to promote municipal investment is expected to record as a result of advance payments from the central government budget were incorporated and the transfer to the reserve were eliminated (like a financial transaction, to which it is, in principle, comparable), this would result in a marked structural surplus – just as it does for the financial balance. In the event of future reserve withdrawals and deficits in the special funds, a correspondingly less favourable budgetary situation would be shown. Overall, central government's structural position could be better captured by taking such a consolidated approach. This would also be appropriate with respect to the corresponding provisions on European deficit limits.

Result set to be somewhat better than projected

The November tax estimate, which was not yet available when the Budget Committee revised the second supplementary budget, forecasts additional revenue of €1½ billion for 2015. Moreover, several other budgeted figures – such as those for return flows from the EU budget and not least for military procurements – still appear to have been calculated cautiously. Notwithstanding the further reduction already forecast in the draft supplementary budget in the light of the highly limited debt service outstanding by the end of 2015, additional interest expenditure savings vis-à-vis the budget plans could also be made. All in all, it is therefore likely that the transfer to the reserve will be markedly higher.

Agreements on cost sharing with state government in connection with refugee influx putting strain on 2016 central government budget

No net borrowing was envisaged in the 2016 draft central government budget,[17] approved by the Federal Cabinet at the start of July, either. However, it did not include estimates for expenditure arising in connection with the marked increase in refugee numbers. Agreements on burden sharing with state government were later implemented in October under the Asylum Procedures Acceleration Act *(Asylverfahrensbeschleunigungsgesetz).* Central government will cede €3½ billion from its shares in turnover tax revenue for 2016 to state government. This sum is intended to cover a large proportion of the costs of benefits for asylum seekers estimated to be incurred at state and local government level. The core element of this legislation is a case-based lump-sum payment of €670 a month per asylum seeker by central government. It was announced in the explanatory memorandum accompanying the draft act that a final settlement taking into account the actual number of refugees will be calculated at the end of each year; the final payments will then be made to-

17 See Deutsche Bundesbank, Public finances, Monthly Report, August 2015, p 70.

gether with the as yet undetermined advance payments for the following year.[18] In addition, improvements to childcare are envisaged by passing on savings of €½ billion via the aforementioned ceding of tax revenue shares – these savings have arisen as a result of the Federal Constitutional Court deeming the childcare supplement granted by central government unconstitutional. Moreover, a fixed amount will be allocated to cover the increase in costs associated with unaccompanied child refugees. Besides the tax transfer, the federal states will receive an additional €½ billion *per annum* for the years 2016 to 2019 to boost the promotion of housing construction. Furthermore, separate legislation provided for higher state government shares in energy tax revenue to promote local public rail transport (€½ billion).

Growing burden arising from basic allowance benefits for asylum seekers granted refugee status

A large share of additional general government expenditure incurred once asylum seekers have been granted refugee status is borne by central government. For example, spending on the basic allowance for job seekers looks set to rise more sharply from 2016 onwards. As well as bearing financial responsibility for unemployment benefit II, central government also pays around one-third of the accommodation costs (this amount varies slightly from federal state to federal state) that, as a general rule, should be covered by local government. Given the foreseeable demand for language and vocational training for the majority of refugees, it is likely that their successful integration into the labour market will, in many cases, take an extended period of time. Accordingly, it is safe to assume that a large number of refugees will draw basic allowance benefits for a prolonged period. As any income that the refugees earn – which is to be offset against transfers from the government – will probably only be low to start with, the amount of funds required per refugee could substantially exceed the average level of benefits drawn by recipients up to now.

Following the Budget Committee's final deliberations on the 2016 central government budget, the expenditure volume provided for in the budget is now €5 billion higher than it was in the draft budget of summer 2015. Of this, €2½ billion has been set aside for the Federal Ministry of Labour and Social Affairs (which is responsible for unemployment benefit II and central government's share of accommodation costs). Against the backdrop of refugee migration, budget provisions were also increased by €1 billion for the Federal Ministry of the Interior (not least for the Federal Office for Migration and Refugees, which is responsible for asylum procedures) and by €½ billion for the Federal Foreign Office (for humanitarian aid and crisis-prevention measures). The November tax estimate forecasts revenue shortfalls of €2 billion in the 2016 central government budget compared with the figures in the draft budget of summer 2015. However, once adjusted for the aforementioned ceding of tax revenue shares to state government, this already equates to an upward revision of €2 billion. In order to avoid any net borrowing, thereby ensuring a "black zero" (ie a balanced budget), there are plans to make a substantial withdrawal of €6 billion from the reserve that is to be created in 2015.

Extensive recourse to reserve envisaged in 2016

Margin to deficit limit shrinking

Under the debt brake, cyclical relief (of €½ billion) and a slight surplus from financial transactions are projected for 2016. The budgets of the off-budget entities to be incorporated were forecast to be balanced overall[19] in the summer draft – forgoing any net borrowing, this results in a small structural deficit. However, if the more appropriate approach described on page 64 were adopted, whereby reserve withdrawals are treated like financial transactions and the expected balances of the relevant off-

18 There will be an advance payment of €3 billion based on an estimate of 800,000 persons who will remain in Germany for an average duration of 5½ months before they are granted refugee status or repatriated. Responsibility for repatriations lies at state government level. Funding will not be provided by central government if rejected applicants remain in Germany for more than one month after their applications have been rejected. In view of the repatriation procedures adopted thus far, this would put significant financial pressure on state and local government; consequently, there remains a financial incentive to accelerate the departure of these persons.
19 Details from the adjustment meeting were not yet available at the time this report went to press.

budget entities are taken into account, a notable structural deficit would be on the cards. As things currently stand, however, this would likely still be below the limit of 0.35% of GDP.

Spending higher than in medium-term plan, too

As usual, the financial plan up to 2019 was not updated during the final budget deliberations. However, the revenue and expenditure figures included in the plan do not take into account the growing budget burden – particularly with respect to unemployment benefit II and central government's share of accommodation costs – arising from the influx of refugees. The level of future transfers of tax revenue to state government envisaged in the explanatory memorandum accompanying the Asylum Procedures Acceleration Act to cover the costs of benefits for asylum seekers will depend on refugee numbers and the implementation of the measures adopted to speed up asylum procedures. Given the current high level of uncertainty, it would seem sensible for the time being to forgo counterfinancing measures in the short term and henceforth use the established safety margins as a buffer. In the event of reduced margins vis-à-vis the debt brake requirements and a possible need to significantly increase integration measures, the question of counterfinancing will, however, likely be raised in future due to the level of additional structural expenditure having become evident by then. In this case, it would then also make sense to once again factor in safety margins vis-à-vis the deficit ceilings until a certain structural surplus level has been reached.

Significantly higher surplus recorded by off-budget entities in 2015 Q3 and also to be expected for year as a whole

Central government's off-budget entities[20] that are summarised in the quarterly overviews by the Federal Ministry of Finance reported a surplus of €4½ billion in the third quarter of 2015 following a surplus of €½ billion one year previously. The bulk of this came from the fund to promote municipal investment (€3½ billion) as it was pre-funded by central government during this period. The surpluses recorded by the civil servants' pension reserve and the civil servants' pension fund in 2014 climbed slightly to a total of €½ billion. After breaking even in the same period last year, the Financial Market Stabilisation Fund (SoFFin) achieved a surplus of €1 billion following the repayment of a capital injection by Deutsche Pfandbriefbank, which was formerly part of Hypo Real Estate. By contrast, the surplus of €½ billion generated by the Restructuring Fund for Credit Institutions in the third quarter of previous years has now been all but eliminated following the transfer of larger banks' levies to the European level. Much like in previous quarters, outflows from the assistance fund set up in summer 2013 to tackle flood damage remained relatively limited. However, in particular, plans enshrined by central government in the first supplementary budget of 2015 to reclaim €½ billion to compensate for transfers from turnover tax revenue to state government in connection with higher costs of benefits for asylum seekers are expected to accelerate spending in the last quarter of the year. In addition to the high surplus recorded by the fund to promote municipal investment, the net transfers to the precautionary off-budget entities and the repayments made to SoFFin, central government now plans to make an advance payment of €1½ billion to the Energy and Climate Fund during the remainder of the year. Overall, the off-budget entities included here are therefore likely to close the year significantly more favourably in 2015 than in 2014 (surplus of around €4 billion, of which €2 billion was attributable to the Investment and Repayment Fund's share of the Bundesbank's profit, which was €0 this year).

State government budgets[21]

State government core budgets also recorded a better result in year-on-year terms in the third quarter of 2015. The surplus increased by just over €½ billion to €2 billion. Revenue rose

20 This notably does not include bad banks and entities keeping commercial accounts.
21 The development of local government finances in the second quarter of 2015 was analysed in greater detail in the short articles in the Bundesbank's October 2015 Monthly Report. These are the most recent data available.

Continued improvement in state government budgets in 2015 Q3 despite higher expenditure growth

by 6% (just over €4½ billion), still bolstered by the strong surge in tax receipts (+7%, or €4 billion). Revenue from public administrations also rose sharply (by €1 billion) owing to the marked increase in central government funds – a large part of which is transferred by individual state governments to their local authorities. Growth in expenditure shot up to just over 5% (€4 billion). Half of this increase was attributable to higher transfers to public administrations, particularly local authorities (+10½%, or €2 billion). Furthermore, personnel expenditure (+3%) and, in particular, growth in other operating expenditure (+12%) both accounted for around €1 billion, while the decline in interest expenditure (-4½%) was somewhat weaker.

Significantly higher surplus in 2015, …

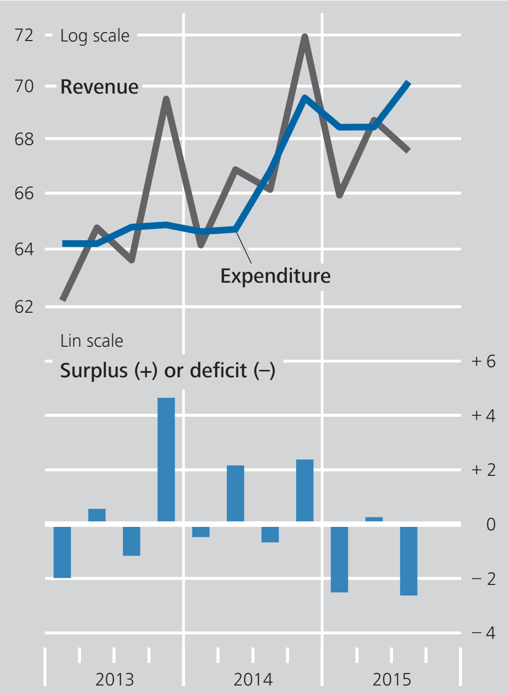
The surplus posted by the state government core budgets came to just over €5 billion for the first three quarters of 2015 and was thus up by €4 billion on the year. The figure for the year as a whole is therefore expected to significantly exceed the previous year's result (surplus of just over €½ billion). Although payments to local government, particularly in connection with the rising costs of benefits for asylum seekers, are likely to be higher again in the final quarter, this will probably be offset by central government ceding a larger part of its turnover tax revenue shares to state government – a measure it recently passed for 2015, too. In the coming years, macroeconomic conditions are likely to remain favourable, tax revenue is expected to record steady growth and interest expenditure is set to continue to decline at first. Compared with the May forecast, the latest tax estimate projects additional receipts for state government of €5 billion in 2015 and €3½ billion in 2016, although the latter are mostly attributable to central government transferring part of its tax revenue shares to state government to compensate for the higher burdens arising from asylum seeker benefits.

… but future rise in burdens owing to refugee influx

At the same time, state government is expected to incur considerable additional expenditure in this regard. In line with its recent decisions, central government will initially provide relief for state government (and local government) by means of lump-sum payments totalling €2 billion in 2015, and then via a kind of payments on account (including fixed components such as higher funds for local public rail transport) in the amount of around €5 billion in 2016. Ultimately, however, central government plans to refund case-based lump-sum payments according to the actual number of immigrants. It announced that, at the end of 2016 (and thereafter annually), it will make a final settlement based on the case-based lump-sum payments. However, it is likely that this lump-sum rate will not be sufficient to actually cover the expected case-by-case costs including education needs. State and local government will therefore also have to make financial contributions. This is likewise the case after an application for asylum has been approved. Central government then assumes the costs of basic allowance benefits for unemployed persons as well as a large share of the accommodation costs. However, the remaining accommodation costs and, in particular, payments for education and childcare will also have to be met by state and local government, which will therefore shoulder a large part of the costs and should, at the same time, be interested in providing the services in a cost-efficient manner. In particular, the agreed regulations set specific incentives, encouraging the authorities to ensure that applicants leave if their applications have been rejected. It is not yet possible to gauge the precise financial impact on state government budgets. But it at least looks likely that surpluses at state government level will be reduced in 2016.

Finances of the German statutory pension insurance scheme

€ billion, quarterly data



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

Social security funds[22]

Statutory pension insurance scheme

Further deterioration in 2015 Q3 with additional expenditure owing to pension benefits package

The statutory pension insurance scheme recorded a deficit of just over €2½ billion in the third quarter of 2015. The generally favourable financial developments were masked by the pension benefits package (especially higher pensions for raising children and the full pension without actuarial deductions from the age of 63 for persons who have been insured for a long period of time) and the year-on-year financial deterioration thus continued. Although the new regulations entered into force on 1 July 2014, the full impact of the expanded benefits on expenditure unfolded with a time lag during the second half of 2014. Contribution receipts rose – despite the cut in the contribution rate from 18.9% to 18.7% – by almost 3% (and, after being adjusted for the contribution rate cut, by as much as close to 4%). Overall, however, the increase in revenue was weaker (at just over 2%) because the instalments of the central government grant had been somewhat higher in the third quarter of 2014 owing to the late approval of the central government budget. Although, at 5%, expenditure growth was still very strong, it was already weaker than it had been in the two previous quarters, which reflects the waning impact of the pension benefits package on year-on-year growth rates.

Gradual easing of spending pressure towards end of year

The mid-year pension increase in 2015 (2.1% in western Germany and 2.5% in eastern Germany) pushed up pension expenditure somewhat more strongly than the previous year's increase.[23] Otherwise, however, growth in these payments was not up on the quarter. This would have been expected solely on account of the likely continued increase in the number of persons taking early retirement from the age of 63. However, it would appear that there is a fundamental trend in the other direction, particularly owing to the gradual rise in the statutory retirement age to 67 and the fact that pressure on expenditure from the especially high number of persons born at the end of the baby boom period entering retirement has not yet come to bear. The component of the pension benefits package to generate the most expenditure by far is the inclusion of an additional child-raising year in the pension calculation (higher "mothers' pensions"). The rise in expenditure associated with this has ground to a

22 The financial development of the statutory health and public long-term care insurance schemes in the second quarter of 2015 was discussed in the short articles of the Bundesbank's September 2015 Monthly Report. These are the most recent data available.

23 As a result of the revision of the national accounts in the summer of 2014, the adjustment was around 1 percentage point lower. Gross wages and salaries per employee are thus around 1% lower. For the pension adjustment, this figure for 2014 was – as stipulated – compared with the unadjusted figure for 2013 that had already been used. However, as pensions generally stay in line with the income subject to contributions of persons in the statutory pension insurance scheme – which is not affected by the revision and for which data are only available at a later date – a correspondingly higher pension increase will be made in 2016.

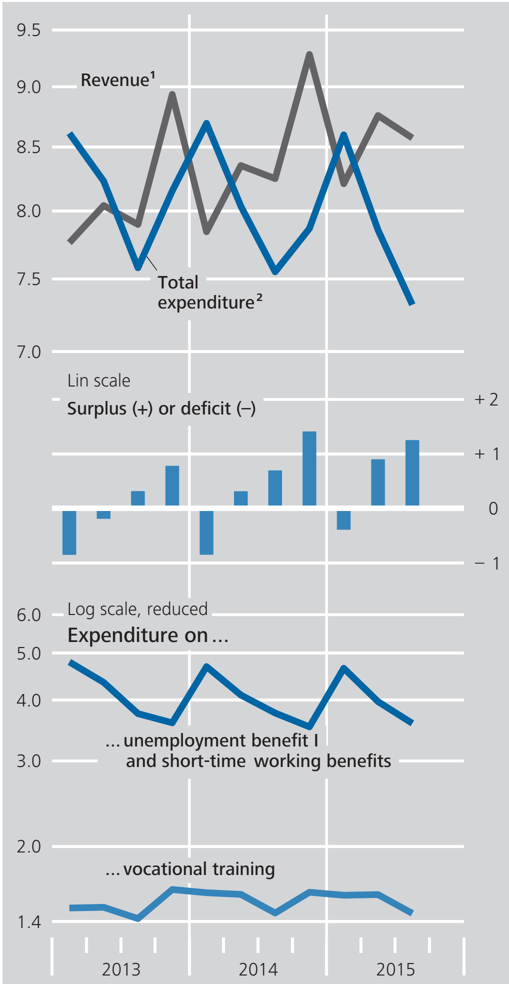
halt following the jump recorded in the previous year.

Contribution rate probably stable in medium term

For 2015 as a whole, developments are set to be more favourable than originally expected. The deficit of €4 billion that had been envisaged when the contribution rate was set is now likely to be lower than expected. The reserves will thus be considerably higher than the regular upper limit of 1.5 times the scheme's monthly expenditure, meaning that, in hindsight, a somewhat further-reaching cut in the contribution rate would have been advisable. As no change in the contribution rate is planned for 2016, the upper limit for the reserves could once again be exceeded at the end of next year. However, as a sizeable deficit is on the cards at the current rate, the upper limit is likely to be undershot by 2017 at the latest; consequently, a cut in the contribution rate is no longer envisaged going forward. The deficit is set to increase further in subsequent years, not least as a result of demographic trends.[24] The current rate could, however, probably be maintained until the end of the decade at least without any risk of the reserves undershooting their statutory lower limit of 0.2 times the scheme's monthly 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

Federal Employment Agency

Further improvement in Agency's finances in 2015 Q3

The Federal Employment Agency recorded a surplus of just over €1 billion in the third quarter of 2015, which – as in the preceding quarters – was €½ billion higher than at the same time last year. At just over 4%, growth in contribution receipts was still substantial. By contrast, on the expenditure side, spending on unemployment benefit I (insurance-related benefit) was down by almost 4%. There were also significant reductions – of around 40% – in subsidies for phased retirement, which is gradually being brought to an end. Expenditure on active labour market policy measures was once again virtually unchanged on the year. However, the administrative costs of the Federal Employment Agency recorded stronger growth of just over 4%. Overall, revenue was up by 4%, while expenditure was down by 3%.

The Federal Employment Agency is set to record a surplus of between €3 billion and €4

24 The current influx of refugees is likely to result in a gradual rise in contribution receipts, while pension expenditure will initially probably hardly increase at all in view of the age structure of the immigrants. If the overall level of employment were higher in Germany, this would, on the one hand, reduce the dampening impact on pensions arising from the sustainability factor as well as from the generally expected increase in the contribution rate, and there would be a somewhat sharper increase in pensions as a result. On the other hand, the below-average earnings of immigrants would likely dampen per capita wage developments, which would result in lower pension increases.

High surplus expected for 2015; refugee influx initially likely to have little impact on Agency's finances

billion at the end of 2015, having forecast a figure of only €½ billion in its budget plan (each of these figures excludes the precautionary fund). The increase in immigration is likely to have hardly any direct impact on the Federal Employment Agency's finances in 2015 – and this is expected to be the case for 2016, too – because most immigrants is expected to have to acquire qualifications before entering regular employment (which is what pushes up the Agency's receipts), and this qualification phase is unlikely to be financed from the Agency's budget. On the expenditure side, the Federal Employment Agency offers insurance benefits, with the general prerequisite of contributions having been paid for one year. Therefore, immigrants able to work are initially only entitled to claim means-tested benefits in connection with the basic allowance for job seekers (particularly unemployment benefit II). It is central government – and, in part, local government – that bears financial responsibility in this regard.