Public finances*

General government budget

In 2015, expansionary budgetary stance masked by more favourable economic conditions and falling interest expenditure

German public finances have benefited for some time now from very favourable underlying conditions. As things currently stand, these are set to continue, although there are uncertainties at the international level, in particular. If the economy runs smoothly on the whole, there is likely to be little change in the fiscal balance, with a surplus of around ½% of gross domestic product (GDP) on the cards for 2015 (2014: 0.7% of GDP). Nevertheless, the fiscal policy stance is generally expansionary, meaning that the balance is likely to worsen significantly after adjustment for interest expenditure and cyclical factors. However, this is masked by the fact that the economy is picking up[1] and interest expenditure is continuing to fall in relation to GDP. The latter is a result of very low interest rates but also reflects the declining debt ratio.

Revenue and expenditure ratios down slightly

The revenue ratio may dip slightly. While the financial impact of various changes to social contribution rates[2] and a reduction in income tax cuts all but balance each other out, other factors such as the Bundesbank's lower profit distribution will depress the ratio. Growth in expenditure is likewise expected to lag behind GDP. This is due, on the one hand, to a sharper rise in GDP owing to cyclical influences. On the other hand, significant growth in some spending categories (particularly pensions, healthcare, long-term care, education, research and infrastructure) will be offset by falling interest expenditure.

Continued decline in debt ratio

The debt ratio had slipped to 74.7% by the end of 2014, with a further marked decline expected for 2015. This is primarily attributable to growth in nominal GDP in the ratio's denominator but is also likely to be bolstered by the positive fiscal balance and a further portfolio reduction by government-owned bad banks.[3]

Similar outlook currently expected for 2016

Developments are currently expected to follow a similar pattern in 2016. While economic activity and falling interest expenditure could provide further relief for the government budget, the budgetary stance is expected to remain expansionary. With a more or less unchanged fiscal balance, the debt ratio is likely to fall further. To date, only a few changes affecting the tax and social contribution burden have been outlined in detail, and another clear rise in primary expenditure (ie expenditure excluding interest payments) is forecast. As in 2015, this is especially the case for social payments. At present, it is still the impact of the selective benefit increases in the statutory pension insurance scheme that is being felt. In 2016, it will instead be that of higher general pension rises. Without any new cost-curbing measures and in the light of recent plans, especially for hospital care, spending on healthcare is likely to again expand significantly. In addition, expenditure

* 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 Pursuant to the Eurosystem's cyclical adjustment method, which is used here, the cyclical impact on the 2014 and 2015 level of the fiscal balance is close to zero, but up somewhat on the year. By contrast, the cyclical adjustment procedure used for EU budgetary surveillance and for central government's debt brake when drawing up the budget paints a clearly negative picture of the economic situation in 2014. Despite GDP being expected to rise significantly, the negative output gap is set to narrow at a relatively slow pace in 2015 as potential growth is assumed to be relatively high.
2 At the start of the year, the contribution rate to the statutory pension insurance scheme was cut and the average additional contribution rate to the statutory health insurance scheme declined, whereas the contribution rate to long-term care insurance was raised considerably.
3 As far as European assistance mechanisms are concerned, additional loans to Greece as part of the current EFSF assistance programme would inflate Germany's debt level. However, the European Stability Mechanism (ESM) would likely be responsible for launching any new programmes. Loans granted by the ESM do not inflate the debt levels of the member states backing the ESM as the ESM is classed as an independent European institution for statistical purposes. Consequently, only new capital injections to the ESM would be recorded in Germany's government account.

Key data of the Federal Government's updated stability programme*

Item	2014	2015	2016	2017	2018	2019
Real GDP growth (%)						
Stability programme April 2015	1.6	1.5	1.6	1.3	1.3	1.3
Stability programme April 2014	1.8	2.0	1.4	1.4	1.4	–
General government fiscal balance (% of GDP)						
Stability programme April 2015	0.6	¼	0	¼	¼	½
Stability programme April 2014	0	0	0	½	½	–
Structural fiscal balance (% of GDP)						
Stability programme April 2015	1.1	¾	¼	½	½	½
Stability programme April 2014	½	½	½	½	½	–
Debt level (% of GDP)						
Stability programme April 2015	74.7	71½	68¾	66	63¾	61½
Stability programme April 2014	76	72½	70	67½	65	–

Source: Federal Ministry of Finance. * The projections in the April 2014 stability programme were still based on the European System of Accounts (ESA) 1995, which was replaced by the revised standards in ESA 2010 in summer 2014. The fiscal balance was only slightly affected by the changeover. However, there was a considerable upward revision of the debt level, while the debt ratio was significantly lower owing to the stronger upward revision of GDP in the denominator. In the updated stability programme for 2014, projection values were rounded up to the nearest ½% of GDP and in the updated version for 2015, values were rounded up to the nearest ¼% of GDP.
Deutsche Bundesbank

will climb in other areas, such as housing allowance, and additional funding has also been earmarked for education, research and infrastructure, among other areas.

Stability programme envisages compliance with EU rules

The Federal Government presented its updated stability programme for the period up to 2019 in April.[4] The general government surplus is expected to decline initially up to 2016 but then rise gradually in the years thereafter. Here, too, an expansionary fiscal policy stance is reported for 2015 and 2016, which will be masked, in part, by favourable economic developments and falling interest expenditure. Nevertheless, European budget requirements will be met with a safety margin.[5] The debt ratio is set to decline to 61½% by 2019.

Put public finances on stable footing when conditions are favourable

In the light of the current decisions on budgetary and financial planning, achieving the targets set out in the German stability programme appears feasible. Given the very favourable underlying conditions, persistently high debt ratio and foreseeable demographic adjustment burdens, it is certainly advisable to exceed the minimum EU requirements. Maintaining a safety margin vis-à-vis the central government's national debt brake in order to be prepared for unpleasant surprises should the situation take a turn for the worse is also to be welcomed. Therefore, the aim in good times should be not to merely balance budgets but rather to allow for marked surpluses. While national rules stipulate that the federal states have to record at least balanced budgets (after cyclical adjust-

4 As part of European budgetary surveillance, EU member states publish a stability or convergence programme every April. The Federal Government regularly bases this on its macroeconomic forecast from the beginning of the year; this forecast and the tax estimate that is based on it are updated shortly afterwards. However, these reassessments have only resulted in a minimal need for adjustment to the fiscal forecast in the latest stability programme (for details on the official tax estimate, see pp 76-77).
5 Although the structural situation appears to again be overstated when calculated in accordance with the method of cyclical adjustment used in European budgetary surveillance, there would, nevertheless, still be a safety margin even if it were calculated using the ESCB procedure.

Fiscal developments in the euro area

General government deficit ratio fell in 2014, but debt ratio continued to rise

At the end of April, Eurostat published data on the general government deficits and debt levels of the EU member states (notification) as part of the European budgetary surveillance procedure. According to these data, the euro-area deficit fell from 2.9% to 2.4% of gross domestic product (GDP) in 2014. This improvement was attributable to subdued interest expenditure, a rebound in economic growth and lower outlays on support for the banking sector. Without these factors, the fiscal stance would have resulted in a slight rise in the deficit ratio. Thus, the euro area's fiscal policy cannot be deemed to have been austere in 2014. The debt ratio continued to rise, from 93.2% to 94.2%.[1]

Debt ratio likewise expected to decrease from 2015

The European Commission's spring forecast expects the euro-area deficit to decrease to 2.0% of GDP in 2015, based on a broadly neutral fiscal policy course. This is attributable to an increasingly positive cyclical impact and a further fall in the interest expenditure ratio. These positive factors are set to continue in 2016, too, with a deficit ratio of 1.7% forecast despite fiscal easing. Not all measures envisaged in the national stability programmes from 2016 onwards, in particular, are taken into account as some of them have not yet been concretely specified. The debt ratio is expected to decline in 2015 – albeit slightly – for the first time since 2007 to 94.0%. This is primarily due to stronger GDP growth. A more significant fall in the debt ratio to 92.5% is on the cards for 2016.

The Greek exception

The situation in Greece still gives cause for concern, and it is virtually impossible to make a reliable forecast at present.[2] The country's outlook had brightened perceptibly up until the end of 2014, as, following a tough adjustment phase, growth had gained a foothold again. The public finance situation could probably have been stabilised without excessive additional fiscal measures. Furthermore, thanks to the extremely favourable interest rate terms granted under the assistance programmes, Greece's general government financing costs are by no means unreasonable despite its very high debt ratio. Thus the country's ratio of interest expenditure to GDP in 2014 was below the figures for Portugal, Italy and Ireland. However, the abrupt change of course embarked on by the new Greek government halted and, in some instances, reversed the reform and stabilisation course. The uncertainty which this created is burdening public finances both indirectly through the setback in economic activity and directly owing to an apparently diminishing willingness to pay taxes. Furthermore, additional expenditures have been approved. The risk premiums on Greek sovereign bonds have consequently increased sharply, and the incipient progress made last year towards regaining access to the capital market has been lost again.

1 Unlike the data reported in the Eurostat notification, the European Commission figures on the debt level in the euro area as a whole cited in this box also include lending between euro-area countries. Excluding these inter-governmental loans, the debt ratio rose by a similar amount to 91.9% in 2014.
2 The European Commission's forecast for Greece cannot be compared with those made for the other euro-area countries. The politically induced uncertainty means that the macroeconomic basis and the fiscal estimate are subject to huge uncertainty.

However, as the assistance programme for Greece – which has since been extended until the end of June – cannot be continued under the current conditions, meaning that no more assistance loans and transfers can be paid, there is an acute danger of Greece becoming insolvent.

Those European countries that have provided assistance up to now and the International Monetary Fund already stopped further payments some time ago as the Greek government has not honoured the existing agreements and has also made no new proposals that could form the basis for a compromise. At present, Greece is managing to stay solvent solely by mobilising the remaining liquidity in its government sector and because Greek banks – which have themselves forfeited access to the capital market – keep rolling over maturing government bonds (T-bills). The latter is only possible as the Greek central bank is granting emergency liquidity, and is moreover continuously extending the amount provided in view of the ongoing outflows of deposits, thereby ensuring the solvency of both the Greek banks and the Greek government in the short term. However, this will probably only be possible for both sectors beyond the immediate horizon if further fiscal assistance payments are made, at least on a temporary basis, and Greece creates a basis for sustainable public finances by implementing economic and fiscal reforms. The decision about providing further funds – which not least involves redistributing considerable risks and hinges on political agreements – should clearly rest with those responsible for fiscal policy and thus with the national governments and parliaments.

A sustainable solution will not be possible without substantial reforms and measures being taken in Greece, which previous Greek governments had committed to. Only this path will ensure that Greece can regain independent access to the capital market in the foreseeable future and that the financial assistance merely amounts to bridging payments, which can be repaid at a later date. This is another reason why the granting of financial assistance should be coupled to corresponding conditionality. It is up to the current Greek government to present suitable proposals, implement the agreements made and thus make its contribution to preventing a sovereign insolvency, which would result in severe dislocations in Greece. Any future agreements should take on board that an easing of the conditions for the fiscal targets would probably delay a return to the capital market and mean that the additional assistance for government financing would have to be higher. A debt waiver by the European Financial Stability Facility (EFSF) and in respect of bilateral loans would currently not help to provide a solution to the Greek government's liquidity problems as the European assistance loans will not mature in the coming years and the associated interest costs are particularly low and, for the most part, deferred for 10 years. By cutting interest rates, granting deferrals and extending maturities, the other countries providing assistance have already granted substantial debt relief, even if these concessions have not been labelled as debt forgiveness.[3]

Consolidation efforts likely to stall in euro-area countries with significant budgetary problems

According to the European Commission's forecast, the deficit ratio will fall up until 2016 not only in the euro area as a whole but also in most of the member states.

3 In 2012, private creditors agreed to a haircut on their claims together with maturity extensions and low interest rate charges.

However, seven euro-area countries (in addition to Greece[4]) are still subject to an excessive deficit procedure (EDP). For Ireland, Slovenia and Portugal, the deadline for correcting the excessive deficit will expire this year. While the European Commission's forecast expects both Ireland and Slovenia to achieve a deficit ratio of just under 3% by the deadline, Portugal could just miss this target. Cyprus is set to correct its excessive deficit on time in 2016, while Spain – which also has a 2016 deadline – is expected to miss the target by a substantial margin. However, there is still scope for additional consolidation measures, particularly for 2016, and the Spanish government plans to meet the deadline. France's deadline for correcting its excessive deficit is 2017 and thus beyond the European Commission's forecast horizon.[5] On an average of the years 2015 and 2016, none of the countries subject to an EDP is expected to record a suitably ambitious improvement in its general government fiscal balance in structural terms, ie net of cyclical effects and one-off measures. In fact, the European Commission even forecasts a structural deterioration for Cyprus, Portugal, Spain and Slovenia if no additional measures are taken. Overall, the forecast reduction in the deficit ratios of the countries subject to an EDP is in all cases largely attributable to the improving macroeconomic situation and lower interest rates. This is not consistent with the objective of the excessive deficit procedure, which is namely to make tangible progress towards achieving sound public finances.

For those countries that are not subject to an excessive deficit procedure, the consolidation process has generally also not yet been completed. Only three of these countries (Germany, Luxembourg and the Netherlands) met the minimum requirement of a structurally (close-to-) balance budget in 2014 and will also comply with the requirement up to the end of the forecast horizon. The other countries should, in principle, reduce their structural deficit by 0.5% of GDP each year (although, in individual cases, a higher or lower amount of improvement can be requested on account of the economic situation, for example). None of the countries concerned is expected to fulfil the fundamental requirement on an average of the years 2015 and 2016, and in four of the countries the structural deficit is actually set to worsen (Austria, Estonia, Finland[6] and Latvia). In countries with very high debt ratios – as is the case in Italy and Belgium, for example – the delay in moving towards the medium-term budgetary objective is particularly problematic.

Since the beginning of the financial and economic crisis, almost all countries have recorded sustained and considerable rises in their debt ratios over many years. A reversal of this trend is envisaged from 2016 at the latest. Only in Finland, Spain and France are the debt ratios expected to continue to climb thereafter in the absence of additional measures. Despite a forecast decline, the second highest debt ratio for 2016 (after Greece) is recorded for Italy (over 130%). Furthermore, debt levels are also expected to exceed GDP in Portugal, Cyprus,

4 Greece is disregarded in the following analysis regarding the key indicators of the Stability and Growth Pact.
5 In addition to complying with the deficit criterion, member states with a debt ratio of more than 60% must rapidly bring it down to this threshold. Malta is subject to an excessive deficit procedure because it failed to comply with the debt criterion. The deadline for correcting this expired in 2014. The European Commission has recommended that the European Council close the procedure.
6 On 13 May 2015, the European Commission published a report pursuant to Article 126.3 of the Treaty on the Functioning of the European Union, which concludes that neither the deficit criterion nor the debt criterion can be deemed to be fulfilled. It is likely to recommend that the European Council open an excessive deficit procedure against Finland.

Forecast for the public finances of the euro-area countries

Country	European Commission spring forecast, May 2015						Deadline for correcting excessive deficit
	Budget balance as a percentage of GDP			Government debt as a percentage of GDP			
	2014	2015	2016	2014	2015	2016	
Austria	− 2.4	− 2.0	− 2.0	84.5	87.0	85.9	–
Belgium	− 3.3	− 2.6	− 2.4	106.5	106.5	106.4	–
Cyprus	− 8.8	− 1.1	− 0.2	107.5	106.7	108.4	2016
Estonia	0.6	− 0.2	− 0.1	10.6	10.3	9.8	–
Finland	− 3.2	− 3.3	− 3.2	59.3	62.6	64.8	–
France	− 4.0	− 3.8	− 3.5	95.0	96.4	97.0	2017
Germany	0.7	0.6	0.5	74.7	71.5	68.2	–
Greece	− 3.6	− 2.1	− 2.2	177.1	180.2	173.5	2016
Ireland	− 4.1	− 2.8	− 2.9	109.7	107.1	103.8	2015
Italy	− 3.0	− 2.6	− 2.0	132.1	133.1	130.6	–
Latvia	− 1.4	− 1.4	− 1.6	40.0	37.3	40.4	–
Lithuania	− 0.7	− 1.5	− 0.9	40.9	41.7	37.4	–
Luxembourg	0.6	0.0	0.3	23.6	24.9	25.3	–
Malta	− 2.1	− 1.8	− 1.5	68.1	67.2	65.4	2014
Netherlands	− 2.3	− 1.7	− 1.2	68.8	69.9	68.9	–
Portugal	− 4.5	− 3.1	− 2.8	130.2	124.4	123.0	2015
Slovakia	− 2.9	− 2.7	− 2.5	53.6	53.4	53.5	–
Slovenia	− 4.9	− 2.9	− 2.8	80.9	81.5	81.7	2015
Spain	− 5.8	− 4.5	− 3.5	97.7	100.4	101.4	2016
Euro area	− 2.4	− 2.0	− 1.7	94.2	94.0	92.5	–

Source: European Commission.
Deutsche Bundesbank

Belgium, Ireland and Spain. Only Estonia, Luxembourg, Lithuania, Latvia and Slovakia are set to comply with the 60% reference value in 2016. The Finnish debt ratio is expected to exceed the reference value from 2015.

European Commission further weakens binding force of fiscal rules

In the coming weeks, on the basis of guidelines provided by the European Commission, the European Council will have to assess whether the requirements of the Stability and Growth Pact have been complied with. In a departure from the normal procedure, decisions for France, Italy and Belgium were already made in March. For France it was evident that it would fall well short of meeting the 2015 deadline initially set for correcting its deficit. Nevertheless, various mitigating circumstances for missing the target were acknowledged. This justified a renewed extension of the deadline, without the procedure being stepped up or sanctions being considered. France now has until 2017 to bring its deficit ratio back down below 3%. The granting of a two-year extension, instead of the one year "generally" envisaged by the regulations, was grounded, *inter alia,* on the structural reforms that the French government has committed to. Overall, this gives the impression that the recommendations are increasingly being adapted to government plans, rather than *vice versa*. For Italy and Belgium, the need to initiate a procedure was considered as these countries fall far short of the agreed quantitative requirements for compliance with the debt criterion (sufficiently diminishing debt ratio). But for these countries, too, various mitigating circumstances were taken into account. In particular, it was argued that the goals are too ambitious and compliance therewith would have undesirable economic repercussions. In view of this, it was decided that expected future convergence with the medium-term budgetary objective of the preventive arm (improvement of the structural

balance) would be taken as the gauge for assessing compliance with the debt criterion. The Commission ruled that the targets of the preventive arm are not being missed to a significant extent and that the debt criterion as a whole is therefore deemed to have been broadly complied with. In Italy's case, this was chiefly facilitated by the fact that the European Commission had significantly lowered the requirement regarding the preventive arm shortly beforehand. Furthermore, in the case of both Belgium and Italy, the Commission likewise took account *inter alia* of planned structural reforms as relevant factors, thereby ensuring that a procedure does not need to be opened. The reform of the Stability and Growth Pact was actually intended to reinforce the debt criterion in order to encourage rapid debt reduction. However, the European Commission's interpretation looks set to largely counteract that intention.

The recent decisions and decision-making processes once again demonstrate that the fiscal framework has in many respects been shaped and interpreted so elastically that a reliable and transparent binding force is achieved in neither the preventive nor the corrective arm of the Stability and Growth Pact. Owing to the growing complexity of the budgetary rules, frequent changes and numerous, open-ended exceptions, it is now barely possible to apply it in a transparent manner. Determining whether or not targets have been missed and procedures need to be stepped up, and thus whether sanctions might have to be imposed, is often no longer rule-based in the strict sense but is above all the result of *ad hoc* considerations and negotiations. It remains to be seen whether the recently announced assessment of the European Council's Legal Service has an impact. This assessment finds that several aspects of the "flexibility" in the Stability and Growth Pact presented by the European Commission are not backed up by the regulations. This could result in the decision-makers being less generous, at least in terms of their liberal consideration of investment spending and structural reforms that are only at the planning stage. However, irrespective of this, there remains large scope for *ad hoc* decisions, with the European Commission's assessments playing a key role. There are increasing signs of a changeover from a rule-based to an institution-based approach in which the fiscal framework is not defined by rules but instead by the European Commission on a discretionary basis. With regard to reliably ensuring sound public finances in the euro area as a key prerequisite for pursuing a stability-oriented monetary policy, the recent developments in connection with the fiscal rules give cause for concern.

ment) only from 2020 onwards, it would be advisable to conclude consolidation as quickly as possible and factor in a certain level of structural surpluses.

Budgetary rules do not put brake on investment but rather create basis for growth-enhancing policy

When national budgetary rules were reformed in the crisis year of 2009, this spelt a regime change for fiscal policy. A structurally balanced government budget was to become the norm and cyclical fluctuations were, as a rule, to be cushioned by automatic stabilisers. The debt brake does not stand in the way of important reforms or investment; instead, it provides an essential foundation by ensuring sustainable public finances. Significant progress has been made in consolidating public finances since 2011. It would be a major step backwards if attempts were made to circumvent budgetary rules in order to create new scope for borrowing – for instance, for government investment.

Cover investment needs without weakening budgetary rules or easing fiscal stance

Many have criticised the level of government investment in Germany as being too low. At the same time, Germany's public infrastructure is still deemed very good in international terms.[6] There is currently much debate as to how much additional expenditure is required. In any case, the aim should be to efficiently eliminate any shortcomings and bottlenecks in the provision of infrastructure rather than achieving certain investment ratios or setting an economic stimulus in order, for instance, to help boost demand in other euro-area countries or lower the current account surplus.[7] After all, the planned moderate structural surpluses in Germany appear to be wholly appropriate in view of both structural and cyclical conditions. The impact of additional investment on other countries is likely to be small, and any plans to fine-tune the economic cycle in other economies using German public finances hold little promise of success. In this regard, any additional need for investment in Germany should be covered without allowing the country's financial position to deteriorate, which is all the more the case as most of it would probably be to cover a need for replacement investment anyway. In addition, it is possible to improve public infrastructure without incurring additional spending to the extent that efficiency reserves that have not yet been depleted can be tapped, in particular in the area of government investment. In general, it would also make sense to spread potential additional projects over a number of years.

Approaches to stepping up government investment activity

An expert commission appointed by the Federal Minister for Economic Affairs recently called, on the one hand, for an expansion of government investment.[8] On the other hand, it also emphasised that the way in which projects are selected and carried out should be improved. It claims that the manner in which state government establishments currently manage central government's orders for the construction of motorways is fraught with flawed incentives. Proposals aimed at improving efficiency – for example, by centralising the provision of expertise – are to be welcomed. For instance, a central contact point could advise local and, where appropriate, state governments on planning, cost management, drawing up contracts and financing issues. Ensuring that cost-benefit calculations are better founded and sufficiently up to date could improve which projects are actually selected. Creating a national motorway association *(Bundesfernstraßengesellschaft),* as proposed in the report, could also help further progress. However, it would be problematic if this were to give rise to a shadow budget enabling borrowing outside the debt brake. Greater involvement of the private sector could also be considered, as has been recommended on a number of occasions, if clear cost benefits could be reaped in specific, individual cases. But it must be ensured that the risks are actually transferred to the private sector rather than creating

6 For instance, according to the Global Competitiveness Report 2014-2015 published by the World Economic Forum, Germany occupies seventh place and has a locational advantage in this regard.
7 See also Deutsche Bundesbank, The German economy's current account surplus, Annual Report 2013, pp 39-60, particularly pp 56-60.
8 Expert Commission, Increasing Investment in Germany, Report Prepared on Behalf of the Federal Minister for Economic Affairs and Energy, April 2015.

subsidised forms of capital investment at the government's expense.

Budgetary development of central, state and local government

Tax revenue

Marked rise in tax revenue in 2015 Q1

Year-on-year growth in tax revenue[9] came to 5% in the first quarter of 2015 (see the chart and table on page 77). This was buoyed by ongoing favourable developments in gross wages and salaries, which have a major influence on tax revenue. Combined with tax progressivity, this resulted in dynamic growth in wage tax revenue. Child benefit – which is deducted from revenue – increased only slowly but still pushed up the growth rate. By contrast, changes in tax legislation (above all, the ongoing increases of tax exemption due to pension expenditure) had a slight dampening effect. Growth in profit-related taxes was below average on balance, at 3%. This growth was driven solely by assessed income tax, whereas revenue from corporation tax as well as non-assessed taxes on earnings fell slightly, while receipts from withholding tax on interest income and capital gains continued to decrease considerably. At 2½%, growth in turnover tax revenue – which is highly volatile – slowed somewhat on the year compared with annual growth in 2014. By contrast, at 4½%, receipts from other consumption taxes were up significantly. However, this is likely to be primarily attributable to one-off effects, such as revenue from motor vehicle taxes returning to normal following a temporary dampening in the first quarter of 2014 due to the transfer of receipts to central government, as well as a subsequent payment of nuclear fuel tax in January following a ruling by the Federal Fiscal Court at the end of 2014.

Revenue growth expected to be sound for 2015 as a whole

The latest official tax estimate expects overall revenue growth (including local government taxes) to be sound (at 3½%) for 2015 as a whole. With respect to the major tax assessment bases, gross wages and salaries are to rise roughly in line with nominal GDP (around 4%), whereas growth in nominal private consumption is set to be somewhat weaker.[10] Fiscal drag[11] will give revenue an extra boost, while tax shortfalls are expected as a result of court rulings. By contrast, on balance, tax revenue is forecast to fall only somewhat as a result of legislative changes.[12]

Revenue growth of a similar size expected in subsequent years

Revenue growth of between 3½% and 4% is also expected for subsequent years up to 2019. Developments are mainly being driven by macroeconomic growth forecasts and fiscal drag. Legislative changes that have already been approved are expected to curb this expansion on balance. The tax ratio (as defined in the government's financial statistics) is thus projected to increase slightly to 22.4% by the end of the forecast period (2014: 22.2%).

Revenue expectations up overall

Compared with the November 2014 forecast, the budgeted figures have been revised upwards by €6½ billion for 2015 and around €8 billion for each of the years thereafter. This is mainly due to more favourable macroeconomic estimates for the current year as well as a

9 Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the quarter under review.
10 This estimate is based on central government's current macroeconomic projection. For 2015, real GDP growth is expected to be 1.8% and nominal growth 3.8% (November: +1.3% and +3.2%, respectively). GDP growth for 2016 is forecast to be 1.8% in real terms and 3.3% in nominal terms (November: +1.3% and +3.1%, respectively). In the medium term, nominal growth of around 3% per annum is still forecast.
11 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.
12 The working party's estimate is based on current tax legislation and thus does not include the planned rise in the basic income tax allowance, the child income tax allowance and the increase in child benefits from 2015 and 2016. By contrast, the gradual changeover to downstream taxation of pensions, in particular, is still causing moderate shortfalls. Expected tax refunds, notably following rulings by the Federal Fiscal Court and the European Court of Justice on the reduction of intermediaries' commission when granting price discounts and the corresponding adjustment of input tax paid by beneficiaries as well as the taxation of dividends paid to EU/EEA companies, are slowing revenue growth.

better-than-anticipated annual result for 2014 compared with the November forecast.

Central government budget

Marked decline in deficit at start of year thanks to strong revenue growth and further easing of interest expenditure burden

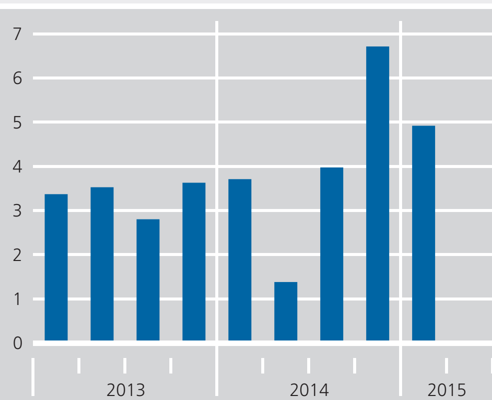
Central government recorded a deficit of €7 billion in the first quarter of 2015 compared with a deficit of €10½ billion one year previously. Revenue rose sharply by 6½% (€4½ billion), with tax revenue climbing by 5% and thus making the largest single contribution (€3 billion). Additional revenue from asset sales (€1 billion) and the extended share of the central government core budget in the Bundesbank's profit distribution (€½ billion) also had a perceptible impact. On the expenditure side, there was a more moderate increase of 1½% (€1 billion) overall. However, given that this growth was broadly distributed across almost all expenditure categories, the increase would have been twice as high if it had not been for a further significant decline in interest expenditure by €1½ billion.

Draft 2015 supplementary budget contains additional burdens for municipal investment fund, …

As there were already indications in the first few months of the year that the goal of a balanced budget in 2015 would probably be exceeded by a considerable margin, the Federal Cabinet adopted the draft of a supplementary central government budget for 2015 in mid-March. Most notably, this envisages transfers of €3½ billion to a central government special fund for promoting investment expenditure by financially weak local authorities. However, irrespective of any need in this regard, the federal states would initially be called upon in addition to the local authorities in question to bring about targeted financial relief. If – as is now planned – central government funds are made available to local government, the use thereof is subject to relatively tight restrictions, as central government is only allowed to provide investment grants for areas that fall under its legislative authority. This could therefore result in funds currently required for particularly urgent matters not being covered by this measure.[13]

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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Tax revenue

Type of tax	Q1 2014 € billion	Q1 2015 € billion	Q1 2015 Year-on-year change %	Estimate for 2015[1,2] Year-on-year change %
Tax revenue, total[2]	140.0	146.9	+ 4.9	+ 3.7
of which				
Wage tax	39.0	41.6	+ 6.5	+ 6.1
Profit-related taxes[3]	23.9	24.7	+ 3.2	+ 2.5
Assessed income tax	11.8	13.1	+ 11.2	+ 6.4
Corporation tax	5.6	5.4	− 3.1	+ 3.8
Investment income tax[4]	6.5	6.1	− 6.0	− 5.8
Turnover taxes[5]	50.5	51.9	+ 2.6	+ 2.5
Energy tax	4.7	4.7	+ 0.6	+ 1.9
Tobacco tax	2.5	2.2	− 10.3	− 2.9

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

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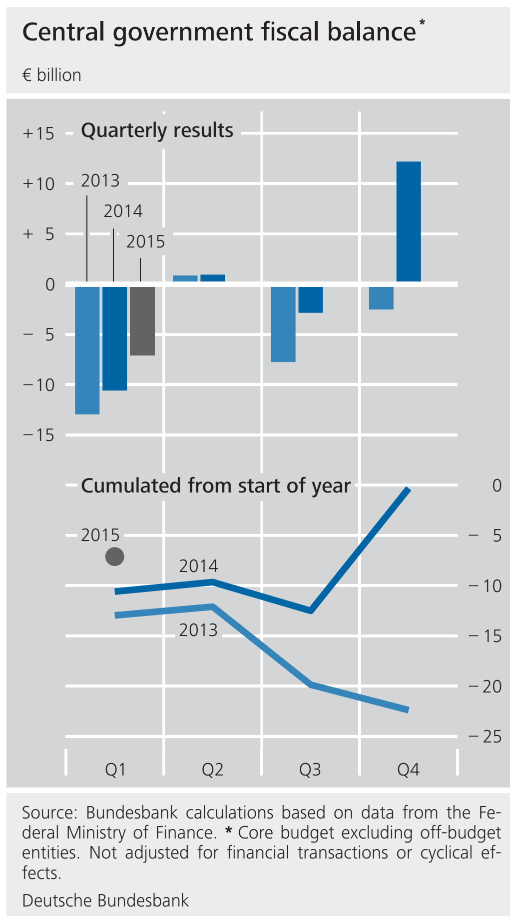
… but still no net borrowing

In addition to the financial resources for the special fund, the draft supplementary budget envisages, in particular, €½ billion higher pay-

13 For instance, the federal states are apparently already calling for an easing of the restriction in funding for schools, for example, where funds are limited to renovation work to improve energy efficiency.

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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ments to the post office pension fund. Assigned turnover tax revenue of €½ billion – to compensate state and local government for the higher burdens arising from the elevated number of asylum seekers – is to be counterfinanced by reclaiming financial resources from the assistance fund (flood assistance fund) set up in the summer of 2013 to tackle damage caused by flooding. In terms of the remaining tax revenue, additional receipts of €3 billion are forecast compared with the previous budget estimate in the light of improved macroeconomic conditions and more favourable revenue developments. A further €½ billion boost in income – which has already been received – comes in the form of the Bundesbank's profit distribution, which was absorbed in its entirety on a one-off basis and thus exceeded the normal statutory upper limit of €2½ billion. Furthermore, on the expenditure side, €½ billion in relief is envisaged owing to lower interest rate levels. On balance, central government is still expected to record a balanced budget with no net borrowing. However, in structural terms, based on the current estimation of potential output and taking into account the expected balances of certain off-budget entities, this nevertheless constitutes a €3½ billion deterioration in the budgetary position in year-on-year terms.[14]

However, year-on-year deterioration in structural balance

Result could once again be more favourable than currently envisaged, but risks also exist

All in all, as things stand, the planned figures appear to be rather cautious. In accordance with the latest tax estimate, if the additionally planned income tax allowances and child benefit are also taken into account, revenue shortfalls of €1 billion would initially have to be offset. Conversely, however, labour market-related spending could be one particular area to fall short of current estimates, and further interest expenditure relief seems feasible given the extremely low interest rate level. Last but not least, the frequency auction due to start at the end of May – for which the total minimum bids for all of the frequency packages already amount to €1½ billion – could generate substantial additional revenue. Although this should, as a rule, be spent on enhancing broadband provision, it may take longer for some of the funds to be spent; these will be released in later years. Risks to the budget plans in con-

14 A balanced structural balance pursuant to the debt brake is recorded in the draft supplementary budget, whereas the original budget had envisaged a surplus of 0.1% of GDP. The deterioration reflects the fact that – based on an unchanged, unadjusted balance – cyclical factors are now expected to have a less negative impact in view of the upward revision of GDP. Under the debt brake rules, if a revision of GDP takes place after final approval of the budget, the cyclical adjustment procedure is not carried out again from scratch; instead, this revision is classified as cyclically induced. By contrast, on the basis of the current recalculation – including potential output – using the Federal Government's procedure, there would still be a relatively high cyclical burden of €3½ billion. Furthermore, off-budget entities are not taken into account consistently in the structural balance for the debt brake recorded in the draft supplementary budget. Thus, on the one hand, the sizeable deficit of the flood assistance fund – which should be included and is listed in the borrowing plan – is not taken into account (although reclaiming financial resources from the fund results in an improvement in central government's structural balance). On the other hand, however, the high surplus of the new municipal investment fund (which is due to advance payments) is also not included (although the resulting burden in the central government budget worsens the figure recorded for the structural balance).

nection with macroeconomic developments and the European sovereign debt crisis remain.

Benchmark figures for 2016 central government budget and for financial plan up to 2019 indicate easing of budgetary course

Along with the draft supplementary budget, the Federal Cabinet also adopted the benchmark figures for both the 2016 budget and the financial plan up to 2019. The goal of a balanced central government budget was maintained. However, the now more favourable macroeconomic projection and the significantly lower interest rate expectations mean that the budgetary course has been eased considerably. Compared with the summer 2014 plan, the estimates for annual interest expenditure, in particular, have been lowered by up to €9½ billion. Furthermore, among other things, an investment programme totalling €10 billion between 2016 and 2018 was already announced in November 2014. A more in-depth analysis of the medium-term budgetary policy of central government must be postponed until the Federal Cabinet decision scheduled for the start of July, which will contain important more detailed information. Nevertheless, given the assumed very favourable underlying conditions up to 2019, it seems wholly appropriate to factor in surpluses. Looming demographic burdens and general budgetary risks are indicators that any relief compared with previous budget estimates should not be used up in its entirety. However, during periods with stable surpluses, it is also advisable – not least following the recent expenditure increases – for additional budgetary leeway to be earmarked to a greater extent for cuts in taxes and social contributions. Alongside the compensation for cold progression, which was recently announced by the Federal Finance Minister for 2014 and 2015, it would also be worth considering reducing the solidarity surcharge.

Perceptible surplus for off-budget entities at start of 2015 and positive result also on the cards for year as a whole

Central government's off-budget entities (excluding bad banks) recorded a surplus of €2½ billion in the first quarter of 2015, compared with €3 billion one year previously. As was the case in 2014, the pension reserves and the postal workers' pension fund recorded moderate surpluses. Furthermore, the ERP special fund and the Energy and Climate Fund – which this year has already received an advance central government grant that is ultimately intended to offset its deficit – each recorded a surplus of €½ billion. The Investment and Repayment Fund (which was established in 2009 to help overcome the severe economic crisis) also recorded a surplus of €½ billion. This constitutes a deterioration of €1½ billion in year-on-year terms. Whereas the surplus in the first quarter of 2014 stemmed from the fund's share of the Bundesbank's profit distribution, the surplus in the first quarter of 2015 is apparently attributable to central government making a redemption payment at the closing of the 2014 budget. The outflows from the flood assistance fund also remained moderate at the beginning of 2015. However, central government's plans to reclaim €½ billion in connection with the asylum compromise, in particular, are likely to contribute to more sizeable payments being made from the fund during the remainder of the year. This will, of course, be set against the likewise newly envisaged allocation of resources to the municipal investment fund in the amount of €3½ billion. All in all, central government's off-budget entities are likely to record a substantial surplus at the end of 2015, which is also due to the surpluses that are still on the cards for the precautionary reserves.

State government budgets[15]

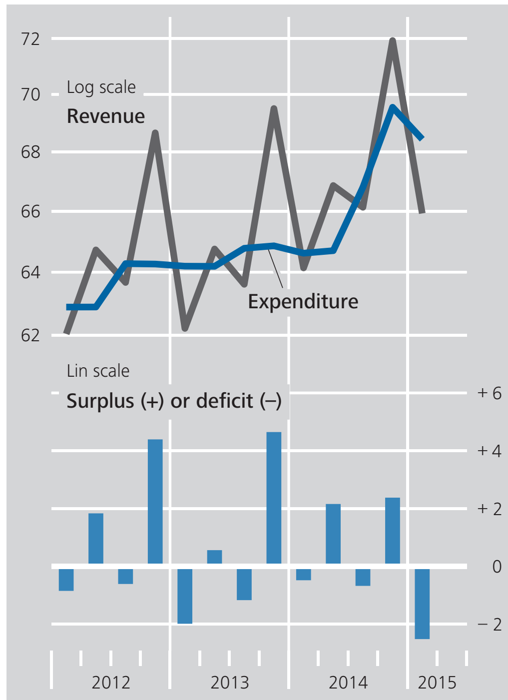
Growth in tax revenue driving improvement in state government budgets in 2015 Q1

State government core budgets recorded a deficit of only €½ billion – which was €1½ billion lower than one year previously – owing to robust revenue developments and moderate expenditure growth. The rise in revenue by 4½% (€3½ billion) was almost exclusively due to the continued dynamic growth in tax receipts (+5½%). The increase in expenditure by 2½% (€2 billion) was driven by transfers to public administrations (+9%, or €2 billion).

15 The development of local government finances in 2014 was analysed in greater detail in the short articles in the Bundesbank's April 2015 Monthly Report. These are the most recent data available.

Finances of the German statutory pension insurance scheme

€ billion, quarterly data



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

However, other operating expenditure also rose significantly (+5½%). Spending on personnel recorded moderate growth – despite the ongoing impetus from pension benefits – while investment expenditure stagnated and the downward trend in interest expenditure continued (-8½%).

Ongoing favourable developments for state government as a whole, …

Given the now upgraded assessment of macroeconomic developments, as well as extremely low interest rates, state government budgets could record somewhat better-than-expected results in 2015. For example, the latest tax estimate (excluding the local government taxes of the city states) for 2015 expects additional revenue totalling €3 billion for state government compared with the autumn 2014 estimate. Overall, there could thus be an improvement in the fiscal balance in 2015 and in the years thereafter. Central government's growing financial support for investment, education (above all, the assumption of state government's share of the costs for student grants and loans), research, day care for small children and social benefits (for example, for asylum seekers) is ultimately likely to play a role here, too, as this also provides relief for state government by *inter alia* reducing the need for it to transfer financial resources to local government from its own funds.

… but some individual states still need to substantially consolidate their finances

Although there is therefore a good chance that state government as a whole will comply with the debt brake requirements enshrined in the German constitution from 2020 onwards, some individual federal states still need to substantially consolidate their finances if they are to meet the requirements. All five federal states in receipt of consolidation assistance are likely to have complied with the agreed deficit reduction paths in 2014 and still have safety margins. Yet the progress towards consolidation seems to be stalling in some cases despite the favourable setting with very low interest rates. In Bremen, for example, the high structural deficit rose perceptibly again according to the latest consolidation report.[16] Looking at the east German states, it needs to be borne in mind that the currently still substantial special supplementary central government grants will be gradually phased out by 2020. Overall, it is still important for many federal states to ensure that they do not let up in their consolidation efforts. If the structural budgetary situation in individual federal states is significantly less favourable than in the majority of states, there is a danger of tax cuts desired by the majority hampering compliance with the debt rule. It does not seem logical for federal states with ongoing structural deficits to receive supplementary assistance from the German state as a whole as part of a federal structure reform – as is occasionally called for – if these states cannot prove that they have exhausted their own scope for action. Extending the federal states' tax autonomy to a certain extent would enlarge the corresponding room for manoeuvre and at the

16 See the report of the Free Hanseatic City of Bremen of April 2015 on the implementation of the restructuring programme 2012-2016 and the press release of the Bremen Senator for Finance of 28 April 2015.

same time appropriately reflect the federal states' own responsibility for budgetary policy, which is often emphasised elsewhere.[17]

Social security funds[18]

Statutory pension insurance scheme

High deficit in 2015 Q1 due to additional expenditure following pension benefits package and cut in contribution rate

In the first quarter of 2015, the statutory pension insurance scheme recorded a deficit of €2½ billion. This constituted a year-on-year deterioration of €2 billion. At almost 6%, expenditure rose extremely sharply, which was primarily due to benefit increases in connection with the pension benefits package (in particular, the mothers' pension and full pension at 63). At just under 3%, receipts still recorded a comparatively strong increase despite the cut in the contribution rate from 18.9% to 18.7%.[19] However, this growth still lagged well behind that of expenditure.

Mid-year pension increase reduced owing to statistical changeover

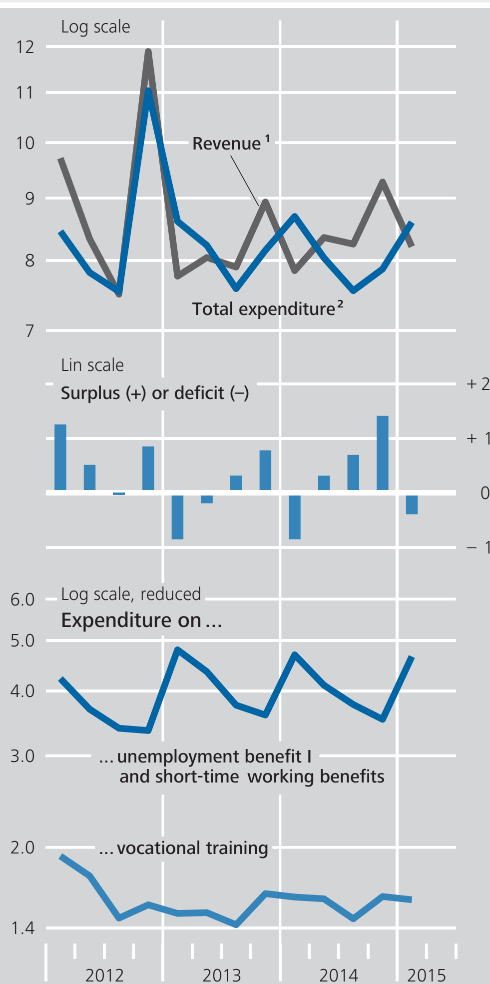
In mid-2015, pensions will be raised by 2.1% in western Germany and 2.5% in eastern Germany. The revision of the national accounts has resulted in the increase being around 1 percentage point lower. In particular, the inclusion of disabled persons employed at special workshops means that gross wages and salaries per employee will now be lower. However, the calculation of the pension adjustment rate is not modified for such "jumps" caused by revisions. Consequently, the average wages for 2014 (which are now lower) are compared with the old value for 2013 (which has not been reduced). But 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 – a correction, and thus a correspondingly higher pension increase, will be made in 2016.

Further contribution rate cut on the cards

Following a surplus of just over €3 billion in 2014, a substantial deterioration in the fiscal balance culminating in a deficit is on the cards for 2015 as a whole. Yet it is unlikely that the reserves will be scaled back to a maximum of 1.5 times the scheme's monthly expenditure, as is actually envisaged if the contribution rate is set in line with the statutory requirements. If favourable employment and wage developments continue, it cannot be ruled out that – based on the contribution rate remaining un-

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

17 See also Deutsche Bundesbank, The reform of financial relations in the German federal system, Monthly Report, September 2014, pp 33-52.
18 The financial development of the statutory health and public long-term care insurance schemes in 2014 was analysed in the short articles of the March 2015 Monthly Report. These are the most recent data available.
19 Viewed in isolation, the cut in the contribution rate causes the growth rate to fall by almost 1 percentage point.

changed and despite the additional expenditure owing to the pension benefits package and the expected sharp pension increase in mid-2016 – the upper limit for the financial reserves will still be exceeded at the end of 2016 as well. In this case, the contribution rate would have to be reduced again in 2016 despite the anticipated deficit.

Federal Employment Agency

Further improvement in Agency's finances in 2015 Q1 …

In the first quarter of 2015, the Federal Employment Agency's deficit halved on the year to just under €½ billion. The continued robust growth in contributions of just over 4% and the slightly sharper rise in refunds of administrative costs were accompanied by cuts in expenditure on unemployment benefit I (insurance-related benefit) and phased retirement subsidies (which are gradually being brought to an end), in particular. Overall, revenue increased by just over 4½% and expenditure fell by 1%.

… and same expected for 2015 as a whole

The extremely favourable developments on the labour market are resulting in lower expenditure on wage substitutes, such as unemployment benefit I, short-time working benefits or insolvency benefit, and facilitating lower expenditure on active labour market policy measures. At the same time, growth in contribution receipts remains high. In view of this, the surplus is set to be significantly larger than last year (€1½ billion, excluding the civil servants' pension fund). If these positive developments continue, the Federal Employment Agency will build up considerable reserves over the coming years, which will provide a financial buffer for less favourable years. Given the positive labour market conditions at present, it certainly seems appropriate to build up reserves. Yet, as a rule, the ongoing favourable labour market situation should not obscure the fact that labour market downturns have a greater impact on the Federal Employment Agency's budget than on the finances of the other social security funds, therefore resulting in any reserves being more rapidly depleted. The current labour market situation and the number of recipients of unemployment benefit I would need to prove to be the new structural norm before any cut in the contribution rate (from the current level of 3.0%) were implemented.[20]

20 For more information, see Deutsche Bundesbank, The evolution of labour market-related government expenditure in Germany, Monthly Report, April 2015, pp 13-33.