Public finances*

General government budget

Continued highly favourable developments in 2017: surplus up, debt down

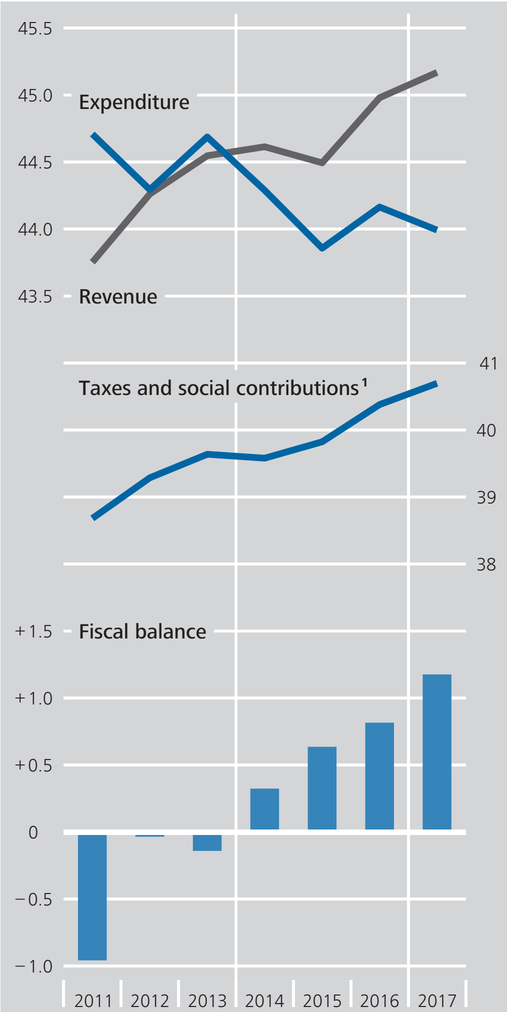
German public finances remained in very good shape last year. According to preliminary data, the general government surplus rose to 1.2% of gross domestic product (GDP). On balance, improvements related to the strong economic upswing and further diminishing interest expenditure. Overall, nuclear fuel tax repayments were more than made up for elsewhere. Renewed dynamic growth in tax and social contribution receipts was accompanied by considerable spending increases in areas such as social benefits, personnel and investment (see also pages 58 to 60). The debt ratio shrank rapidly. That said, at 65.1% at the end of the third quarter, it was still well above the 60% threshold. The lion's share of the decline by 3 percentage points compared with the end of 2016 was attributable to nominal GDP growth in the ratio's denominator. However, as a result of the surpluses in the central, state and local government budgets and the portfolio reduction at government-owned bad banks,[1] gross debt also fell significantly.

Conditions set to remain extremely favourable

As things stand, conditions for public finances look set to remain extremely favourable over the next few years. Increasingly positive cyclical effects and declining interest expenditure will bring relief to government budgets. Furthermore, there will be a year-on-year improvement in the balance owing to the fact that nuclear fuel tax repayments have come to an end. However, it has to be assumed that the exceptional growth in profit-related taxes will normalise, with growth in structural primary expenditure[2] remaining comparatively high.[3]

General government fiscal ratios*

As a percentage of GDP



* As defined in the national accounts. **1** Taxes and social contributions plus customs duties and bank levies to the European-level Single Resolution Fund.

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* The section entitled "General government budget" relates to data from the national accounts and the Maastricht debt ratio. The subsequent more detailed reporting on the budgets of central, state and local government and of the social security funds pursuant to available data is based on the figures as defined in the government finance statistics (which are generally in line with the budget accounts).

1 The portfolio reduction and scaling-back of corresponding liabilities are rather volatile. For example, occasionally pronounced fluctuations in cash collateral in connection with derivatives transactions are reflected in the debt level. Deleveraging at FMS Wertmanagement (recorded in the government sector) could be delayed if it repurchases additional liabilities belonging to the DEPFA Group (not classified as part of the government sector) under the DEPFA resolution process.

2 Variables are defined as structural if cyclical factors and significant temporary effects are deducted. Primary expenditure (primary balance) refers to expenditure (fiscal balance) excluding interest expenditure.

3 A return to higher payments to the EU is one factor that will probably contribute to this. These were relatively low last year but are expected to pick up over the course of the current financial planning period, before increasing markedly after the United Kingdom's exit from the EU is finalised.

The structural development of German public finances – results of the disaggregated framework for 2017

Germany's general government budget posted another surplus in 2017. According to preliminary data from the Federal Statistical Office, the surplus amounted to 1.2% of gross domestic product (GDP) and was once again distinctly higher than in the previous year (0.8% of GDP).[1] The role played by cyclical influences and specific temporary effects is estimated using the "disaggregated framework" for analysing public finances.[2] The framework also shows the major determinants of any other changes – which are classified as structural – in the expenditure and revenue ratio. The main results of this analysis for 2017 are presented below.[3]

While favourable cyclical developments continued to ease the strain on government budgets in year-on-year terms, this was more or less cancelled out by temporary one-off effects (in particular, the repayment of nuclear fuel tax owing to a ruling by the Federal Constitutional Court, but also support provided to HSH Nordbank).[4] Thus, both the unadjusted and the structural (adjusted for cyclical influences and temporary effects) surplus ratio increased by 0.4 percentage point.

The unadjusted revenue ratio climbed by 0.2 percentage point and the structural ratio rose by only a little more (+0.3 percentage point). The main reason for the rise in the tax and social contributions ratio was continued high growth in profit-related taxes, which cannot be entirely accounted for by the increase in entrepreneurial and investment income and the impact of legislative changes (residual: +0.3 percentage point).[5] In addition, GDP contained more "revenue-rich" components and fiscal drag[6] had its usual slightly positive effect. The latter was offset on balance by cuts in taxes and social contributions. However, a small reduction in income tax and the gradual changeover to deferred taxation of pensions, in particular, caused revenue shortfalls which could not be fully offset by the higher contribution rate to the long-term care insurance scheme.

The expenditure ratio decreased slightly in both unadjusted and structural terms (-0.1 and -0.2 percentage point respectively). Favourable economic developments pushed down the unadjusted ratio – mainly due to strong nominal GDP growth in the ratio's denominator. However, this was largely offset by the above-mentioned temporary effects. The interest expenditure ratio fell again somewhat on the back of the beneficial funding terms and the reduc-

1 As defined in the national accounts.
2 For more information on the methodology used, see Deutsche Bundesbank, A disaggregated framework for analysing public finances: Germany's fiscal track record between 2000 and 2005, Monthly Report, March 2006, pp 61-76.
3 These results are subject to amendments arising from subsequent revisions to the national accounts figures or to the macroeconomic outlook.
4 Due to the Federal Constitutional Court's June 2017 ruling that nuclear fuel tax is void, central government had to make payments in the amount of 0.2% of GDP. These are recorded in the national accounts as capital transfers payable. By comparison, the temporary burdens recorded thus far for calls on state government guarantees issued for HSH Nordbank have been significantly lower.
5 Marked residuals have also been observed in the past. They are related, in particular, to the fact that the macroeconomic reference variables available and the structures modelled for time lags can only roughly approximate changes in tax payments.
6 In this context, the term "fiscal drag" encompasses the overall revenue effect of bracket creep in income taxation and the impact of the fact that specific excise duties are largely independent of prices.

Structural development*

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

Item	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total 2008 to 2017
Unadjusted fiscal balance[1]	– 0.4	– 3.1	– 1.0	3.3	0.9	– 0.1	0.5	0.3	0.2	0.4	1.0
Cyclical component[1]	0.4	– 1.7	0.2	0.8	0.0	– 0.5	– 0.1	0.0	0.2	0.2	– 0.4
Temporary effects[1]	– 0.3	0.2	– 1.0	1.1	– 0.1	0.1	– 0.3	0.3	– 0.1	– 0.2	– 0.3
Fiscal balance	– 0.4	– 1.4	– 0.3	1.3	1.0	0.3	0.8	0.0	0.1	0.4	1.7
Interest payable	0.0	– 0.2	– 0.1	0.1	– 0.2	– 0.3	– 0.2	– 0.2	– 0.2	– 0.1	– 1.5
Owing to change in average interest rate	– 0.0	– 0.3	– 0.3	– 0.1	– 0.2	– 0.3	– 0.1	– 0.1	– 0.1		– 1.7
Owing to change in debt level	0.0	0.1	0.3	0.2	0.0	– 0.0	– 0.1	– 0.1	– 0.1		0.2
Primary balance	– 0.4	– 1.7	– 0.4	1.4	0.8	– 0.0	0.6	– 0.2	– 0.1	0.2	0.2
Revenue	0.2	– 0.9	– 0.2	1.1	0.0	0.2	0.2	– 0.1	0.5	0.3	1.3
Taxes and social contributions	0.2	– 1.0	– 0.4	0.7	0.1	0.3	0.1	0.2	0.5	0.4	1.1
Fiscal drag[2]	0.0	0.1	– 0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.8
Decoupling of macroeconomic reference variables from GDP	0.2	– 0.3	0.2	0.2	– 0.0	– 0.1	– 0.0	– 0.1	0.1	0.1	0.3
Legislative changes	– 0.6	– 0.3	– 0.6	0.2	– 0.1	– 0.2	– 0.1	0.0	– 0.1	– 0.1	– 1.8
Residual	0.5	– 0.6	0.0	0.2	0.2	0.5	0.1	0.2	0.4	0.3	1.9
of which profit-related taxes[3]	0.5	– 0.6	0.2	0.2	0.3	0.1	– 0.0	0.1	0.4	0.3	1.5
Non-tax revenue[4]	0.1	0.2	0.2	0.4	– 0.2	– 0.1	0.1	– 0.3	– 0.1	– 0.1	0.2
Primary expenditure	0.7	0.8	0.2	– 0.3	– 0.8	0.2	– 0.4	0.2	0.6	0.0	1.2
Social payments[5]	0.2	0.2	– 0.0	– 0.3	– 0.2	0.1	0.0	0.2	0.4	0.2	0.7
Subsidies	– 0.0	0.3	– 0.1	– 0.1	– 0.1	0.0	– 0.0	– 0.0	– 0.0	– 0.0	– 0.2
Compensation of employees	0.1	0.1	0.1	0.0	– 0.1	– 0.1	– 0.0	– 0.1	0.0	0.1	0.0
Intermediate consumption	0.2	0.2	0.2	0.1	– 0.0	0.1	0.0	– 0.0	0.1	– 0.0	0.8
Gross fixed capital formation	0.1	0.1	0.0	0.0	– 0.1	– 0.1	– 0.1	0.0	0.0	0.0	0.2
Other expenditure[6]	0.1	– 0.2	0.0	0.1	– 0.2	0.3	– 0.3	0.1	0.1	– 0.2	– 0.4
Memo item											
Pension expenditure[7]	– 0.0	– 0.1	0.0	– 0.1	– 0.2	– 0.3	– 0.0	0.1	0.1	0.1	– 0.5
Healthcare expenditure[8]	0.2	0.2	0.1	0.0	– 0.0	0.2	0.2	0.0	0.1	0.0	0.9
Labour market expenditure[9]	0.1	0.1	– 0.3	– 0.3	– 0.2	– 0.1	– 0.2	– 0.1	0.0	0.0	– 0.9
Long-term care expenditure[10]	0.0	0.0	0.0	– 0.0	0.0	0.0	0.0	0.1	0.0	0.2	0.4

* The structural figures are derived by adjusting for cyclical influences and specific temporary effects. **1** Year-on-year change in the ratio to nominal GDP. **2** In this context, the term "fiscal drag" encompasses the overall revenue effect of bracket creep in income taxation and the impact of the fact that specific excise duties are largely independent of prices. **3** Assessed income tax, corporation tax, local business tax, investment income tax. **4** Other current transfers receivable, sales and total capital revenue. **5** Including other current transfers to households. **6** Other current transfers payable to corporations and the rest of the world, other net acquisitions of non-financial assets and capital transfers payable. **7** Spending by the statutory pension insurance scheme, spending on recipients of civil servant pensions as well as payments by the Post Office Pension Fund and the Federal Railways Fund. **8** Spending by the statutory health insurance scheme and assistance towards civil servants' healthcare costs. **9** Spending by the Federal Employment Agency (excluding the reintegration payment paid to central government (from 2008 to 2013)) and central government expenditure on unemployment benefit II and on labour market reintegration measures. **10** Spending by the public long-term care insurance scheme.

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tion in the debt ratio.[7] The other structural expenditure (primary expenditure) ratio remained unchanged. For instance, on the one hand, the structural social expenditure ratio rose (above all for expenditure on long-term care). On the other hand, however, transfers to the EU budget as well as capital transfers (adjusted for temporary effects) declined.

Overall, public finances benefited in 2017, too, from very favourable conditions. Dynamic growth in profit-related taxes, favourable cyclical developments and a further decline in interest expenditure more than offset temporary burdens (caused, in

7 The breakdown of the change in the interest expenditure ratio for 2017 is not shown as the debt ratio for the year's end is not yet available.

particular, by nuclear fuel tax being declared void).

In comparison with 2007, ie prior to the financial and economic crisis, the structural fiscal balance saw an improvement of just over 1½ percentage points of GDP. On balance, this was entirely attributable to favourable funding conditions. The interest expenditure ratio therefore fell by 1½ percentage points during this period solely due to the drop in the average interest rate on government debt. At 2½% as this report went to press, the structural primary surplus ratio (after adjustment for this development) thus roughly matched its 2007 level. After a period of clear deterioration up to 2010 followed by a period of improvement up to 2014, the ratio has remained virtually unchanged for the past three years. Extraordinary growth in profit-related taxes (positive residuals) has been concealing a moderately expansionary fiscal stance.

Under the financial plans published up to now, an overall surplus of around 1½% of GDP would be expected for 2018,[4] potentially followed by another slight increase. The fiscal policy stance would be moderately expansionary and the structural surplus would still be in the order of 1% of GDP. However, when the new Federal Government is formed, central, state and local governments (with central government setting the budgets of the social security funds as well) are expected to use this favourable outlook for additional spending as well as tax and social contribution cuts. As a result, the general government surplus is likely to be distinctly smaller going forward. Nonetheless, the debt ratio will probably fall below the 60% mark again by 2019 at the latest.

Avoid short-term policy oriented to cash balance …

The fact that the recently unveiled coalition agreement between the CDU, CSU and SPD[5] retains the fundamental objective of a balanced budget and will thus continue to prioritise sound public finances is welcome. While the substantial surpluses do provide fiscal space, the focus on a budget without net borrowing creates problems. It would therefore be reasonable, first, to allow positive cyclical effects to pass through to the budgets so as to avoid procyclical or erratic fiscal policy should the situation take a turn for the worse. This is why the fiscal rules prescribe structural budget limits, which enable the automatic stabilisers to work (ie to run surpluses in upswings and deficits in downturns). Second, compliance with the deficit ceiling set out in the European Fiscal Compact must be ensured if reserves are used to cover new budgetary burdens.[6] Furthermore, there needs to be a guarantee in such an instance that medium and longer-term burdens

4 Risks remain in connection with state government guarantees issued for HSH Nordbank.
5 Reference is made, both here and in the rest of the article, to the agreement of 7 February 2018, which, as this report went to press, had not yet been approved.
6 For information on the central government refugee reserve, see also p 64.

can be sustainably financed once the reserves have been exhausted, if not before.

… by planning for moderate structural surpluses and …

Generally speaking, to achieve a steady, medium to long-term fiscal policy, it is advisable to aim for moderate structural surpluses in financial plans at the central, state and local government level. With such budgetary buffers in place, even the blow of distinctly adverse developments can be cushioned rather than needing to be offset as early as in the next budget. Owing to the rapid decrease in the debt ratio associated with structural surpluses, this would also make it easier to cover soaring, demographically driven expenditure (while revenue grows more slowly) in the foreseeable future. For example, central government will be affected by increasing central government grants to the pension insurance scheme, while state governments will be confronted with rising pension costs.

… ensuring transparent tax financing of non-insurance-related benefits

Demographic challenges lie ahead for the pension insurance, public long-term care and health insurance schemes. Looking ahead, their reserves will shrink and contribution rates will rise considerably – all without additional benefit increases. In order for public finances to be open and transparent, it would be expedient to report the social security funds' non-insurance-related benefits and base tax grant levels on the size of these benefits. General social benefits would then be easier to identify and would be financed by society as a whole via progressive taxation. In addition, it would avoid creating the impression of shuffling funds between the central government budget and the social security funds.

Financial leeway utilised under coalition deal

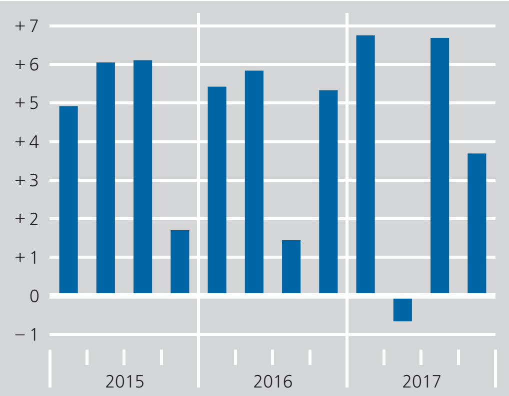
There will be some financial leeway available at all levels of government over the next few years, even with aims to achieve modest structural budget surpluses. With respect to the social security funds, this applies to the Federal Employment Agency, for which a contribution rate reduction has been agreed in the coalition deal. In the case of the statutory health insurance scheme, the contribution rate could also fall if it receives higher payments from central government for persons claiming unemployment benefit II and if the additional costs for benefit increases are limited. In addition, it was agreed that the solidarity surcharge (which is paid to central government only) would be partially abolished. Surpluses at the state and local government level could, as a whole, lead to individual governments cutting real estate acquisition tax rates or local business and real estate tax multipliers, which have been raised in multiple cases in the past. On the expenditure side, additional funding has been earmarked under the coalition agreement for areas such as childcare, education, internal security and digitalisation. Some projects will require coordination between central, state and local governments. What would be detrimental here would be for the lines of responsibility to become too blurred as a result of greater financial interconnectedness.

Prospect of a more fundamental pension reform

On the expenditure side, there is a focus on expanding social security in old age. The aforementioned separation of non-insurance-related benefits that are, in principle, to be financed out of general taxation, on the one hand, and what are essentially contribution-equivalent benefits, on the other, appears particularly important in this context. The issue of how to address the demographic challenges facing the statutory pension insurance scheme is to first be referred to a commission. Of key importance here are consistent projections with a long horizon, which should – as is usual for current sustainability analyses – span at least as far as 2060. In order to limit the significant increase in the contribution and tax rates (to finance additional central government grants) that is expected in any case, two points should be considered here: first, raising the statutory retirement age further in line with increasing life expectancy and, second, looking ahead, lowering pension levels. It would appear appropriate to combat demographic developments with measures to counteract the shortage of potential labour supply.

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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Budgetary development of central, state and local government

Tax revenue

Significant increase in tax revenue despite nuclear fuel tax repayment in 2017

Despite the burden arising from the repayment of nuclear fuel tax to owners of nuclear power plants,[7] tax revenue[8] rose significantly by 4% in 2017 (see the above chart and the table on page 63). The annual result was therefore broadly in line with the official estimate of November 2017. While wage tax and turnover tax receipts were somewhat lower than projected, income from profit-related taxes grew more strongly. Overall, growth was broad-based in year-on-year terms. Revenue from profit-related taxes rose sharply once again – starting from an already high level in the previous year. Assessed income tax remained on a strong growth path, while the increase in corporation tax was down compared with the major boost recorded in 2016. The likewise dynamic rise in wage tax receipts primarily reflects the favourable developments in gross wages and salaries. The additional revenue generated by fiscal drag in income taxation was largely offset by revenue shortfalls resulting from legislative changes (in particular, slightly higher income tax allowances and a rightward shift in other income tax thresholds). Turnover tax revenue rose considerably in line with the macroeconomic reference variables, and revenue from the excise duties on energy and tobacco was also up significantly.

Underlying dynamic remains favourable in 2018 and medium term

According to the official estimate of November 2017, an increase in tax revenue of around 4% (including local government taxes) is expected for 2018. The revenue shortfalls stemming from legislative changes will more or less offset fiscal drag on balance.[9] Revenue will increase on account of the overall burden of tax refunds in connection with court rulings decreasing significantly in net terms. Growth is estimated at around 4% *per annum* between 2019 and 2022. This is primarily the result of macroeconomic assumptions and fiscal drag.

Only limited tax cuts envisaged for current legislative period

Growth could be dampened by the tax policy measures of a new Federal Government. Overall, only limited tax cuts have been outlined in the coalition agreement between the CDU, CSU and SPD – in particular, the scaling-back of the solidarity surcharge, which is to begin in 2021, the last year of the legislative period. This is to be generally regarded as a positive move. However, the plan to only abolish the solidarity surcharge up to an exemption limit could give rise to very high marginal tax rates in some areas, plus it is envisaged that the surcharge on corporation tax will be maintained. Given that special-purpose grants to the federal states in eastern Germany are to be phased out by 2020, the original justification for the add-on to income taxes appears increasingly dubious. In this regard, it would make sense to either

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7 Following a ruling by the Federal Constitutional Court published on 7 June 2017 (2 BvL 6/13), central government was required to repay all nuclear fuel tax payments (including interest of €7½ billion, or 1% of total tax revenue).
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 The Working Party on Tax Revenue Forecasting issues projections on the basis of current tax legislation. 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.

Tax revenue

Type of tax	Year as a whole 2016 € billion	Year as a whole 2017 € billion	2017 Year-on-year change € billion	2017 Year-on-year change %	Estimate for 2017 as a whole[1,2,3] Year-on-year change %	Q4 2016 € billion	Q4 2017 € billion	Q4 2017 Year-on-year change € billion	Q4 2017 Year-on-year change %
Tax revenue, total[2]	648.3	674.6	+ 26.3	+ 4.1	+ 4.0	175.8	182.3	+ 6.5	+ 3.7
of which									
Wage tax	184.8	195.5	+ 10.7	+ 5.8	+ 5.9	52.3	54.7	+ 2.4	+ 4.7
Profit-related taxes[4]	106.7	116.9	+ 10.3	+ 9.6	+ 8.6	25.8	27.4	+ 1.6	+ 6.1
Assessed income tax	53.8	59.4	+ 5.6	+ 10.4	+ 10.2	14.4	14.9	+ 0.5	+ 3.1
Corporation tax	27.4	29.3	+ 1.8	+ 6.6	+ 3.9	6.1	6.8	+ 0.7	+ 11.6
Investment income tax[5]	25.4	28.3	+ 2.9	+ 11.3	+ 10.5	5.2	5.7	+ 0.4	+ 7.8
Turnover taxes[6]	217.1	226.4	+ 9.3	+ 4.3	+ 4.4	56.1	58.1	+ 2.1	+ 3.7
Other consumption-related taxes[7]	90.1	92.2	+ 2.1	+ 2.3	+ 2.5	27.4	27.6	+ 0.2	+ 0.6

Sources: Federal Ministry of Finance and Bundesbank calculations. **1** According to official tax estimate of November 2017. **2** Including EU shares in German tax revenue but excluding receipts from local government taxes. **3** Tax revenue including (still estimated) local government taxes was €10½ billion above the November 2016 estimate, which formed the basis for the 2017 central government plan drawn up at the end of 2016. According to government assessments, tax revenue would have been revised upwards by €22½ billion if the effects of legislation passed and court rulings published (or applied by the tax authorities) since the estimate are removed. **4** Employee refunds deducted from revenue. **5** Withholding tax on interest income and capital gains, non-assessed taxes on earnings. **6** Turnover tax and import turnover tax. **7** Taxes on energy, tobacco, insurance, motor vehicles, electricity, spirits, air traffic, coffee, sparkling wine, intermediate products, alcopops, betting and lottery, beer, fire protection.

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abolish it completely or integrate it into the income tax scale in future.

Harmonisation of corporate taxation in EU still envisaged

For a potentially more fundamental reform of corporate taxation, the coalition agreement points to aims for a harmonised European corporate tax setting. With respect to investment conditions in Germany, it appears crucial, *inter alia,* to keep an eye on international trends – such as tax cuts in the United States – and, where necessary, make adjustments in Germany, too. However, at the local government level, it was possible to create scope in many places to lower local business tax multipliers – not least thanks to the agreement reached to extend central government grants.

Abolition of withholding tax on interest income not without its problems

The abolition of withholding tax on interest income was also announced. It should be noted that interest income offsets increasing prices to a certain degree and, to this extent, does not increase one's ability to pay tax. If this is not taken into account, the real tax burden of interest income can be very high.[10] Furthermore, the intention to restrict scope for design at the interface between debt and equity capital and between interest income and capital gains may prove difficult in practice.

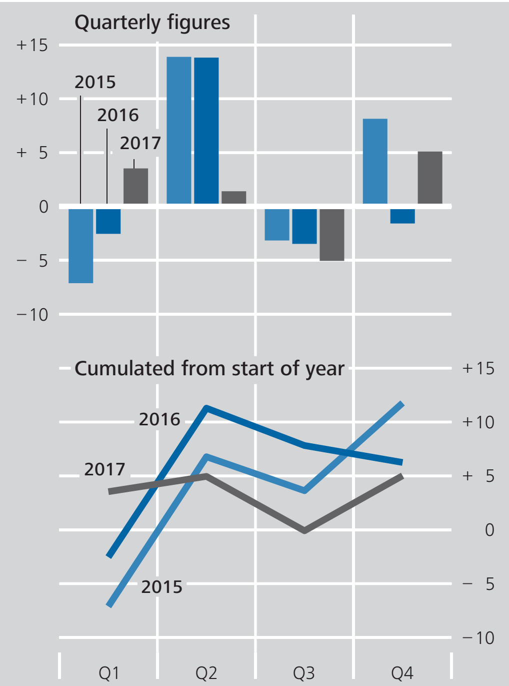
Various measures focused on housing

Real estate tax is to be secured as a local government financing source. Non-trivial adjustments may need to be made swiftly to make this happen, not least on account of a ruling by the Federal Constitutional Court that is expected to be made in summer. Generally speaking, the entire resident population is affected by this tax. Given its comparatively low distortionary impact and the reliable, steady revenue it generates, it is very well suited as a source of funds for local government. Subject to a constitutional review, there are also plans to provide local governments with an additional tool by introducing a "real estate tax C" – which will

10 See also Deutsche Bundesbank, Return on private financial assets taking into account inflation and taxes, Monthly Report, July 2017, pp 69-75.

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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probably target the taxation of undeveloped residential land. This measure appears to be a suitable way of increasing the supply of housing in sought-after regions in a targeted manner.[11] The planned home buyers' child benefit for first-time buyers could, in particular, further hike the prices of building plots and existing properties – especially in the current climate. If this happens, the measure would not have the desired effect of making it easier for families to become property owners. As this measure will put a significant strain on the central government budget in the medium term, it appears questionable on the whole.

Central government budget

Slightly lower surplus in 2017 as a whole

According to preliminary data, the central government budget recorded a surplus of €5 billion last year. This equates to a year-on-year decline of €1 billion. Revenue expanded by 4% overall. Going up by 6½% (€21 billion), tax revenue grew even more steeply. This is largely due to favourable macroeconomic developments. The repayment of nuclear fuel tax ordered by the Federal Constitutional Court was offset by a sharp decline in transfers to the EU budget.[12] A decrease of €7½ billion was recorded for non-tax revenue, the bulk of which was attributable to the Bundesbank's lower profit distribution and the one-off reclamation of €1½ billion from the flood relief fund in 2016. Expenditure grew at only a slightly higher rate than revenue. Especially noteworthy here is a clear rise in transfers, particularly to the social security funds (+€5 billion). Having fallen considerably in previous years, interest expenditure stagnated owing to the fact that persistent refinancing advantages were offset by lower premiums and additional payments to the precautionary fund for final payments of inflation-indexed Federal securities.

Result more favourable than planned; further top-up of refugee reserve questionable

The fiscal balance was therefore up by €12 billion on the budget plan approved in autumn 2016. As in the previous year, the planned withdrawal from the refugee reserve (€6½ billion) was not required. Instead, aiming for a "black zero" budget – a budget without net borrowing or debt repayment – resulted in the reserve expanding by a further €5½ billion to €24 billion. For three consecutive years now, marked surpluses have been recorded despite the expenses incurred by central government in connection with refugees. In view of this, there is no longer a discernible need for such a special reserve. The Federal Court of Auditors expressed concern at this, not least with respect to preserving the budgetary principle of annuality.[13] A timely dissolution of the reserve to repay debt in the budget would therefore be appropriate. Furthermore, this would be in line with European budget rules, under which re-

11 The extent to which the housing supply can be efficiently expanded depends not least on the quantitative importance of vacant building plots in urban areas.
12 A large proportion of this is attributable to the one-off effect of retroactively applying the EU own funds ruling of autumn 2016 to the budget.
13 See Bemerkungen 2017 des Bundesrechnungshofes zur Haushalts- und Wirtschaftsführung des Bundes, Bundestags-Drucksache 19/179, p 144.

Key central government budget data in connection with the debt brake*

Item	2016 Actual	2017 Budget	2017 Provisional actual	2018 2017 summer draft[1]
1 Fiscal balance	6.2	− 7.0	5.0	− 8.4
2 Coin seigniorage	0.3	0.3	0.3	0.3
3 Transfer to (–)/withdrawal from (+) reserves	− 6.5	6.7	− 5.3	8.2
4 Net borrowing (1+2+3)	–	–	–	–
5 Balance of financial transactions	0.6	− 0.7	− 0.8	0.6
6 Cyclical component in the budget procedure	− 0.4	− 1.9	[2] 2.4	− 0.4
7 Balance of incorporated off-budget entities	1.0	− 3.2	− 1.4	− 2.5
Energy and climate fund	− 0.0	− 1.5	− 0.2	− 0.8
Flood assistance fund	− 2.3	− 1.0	− 0.7	− 0.3
Fund to promote municipal investment	3.4	− 0.8	− 0.5	− 1.4
8 Structural net borrowing (4−5−6+7) (repayment: +; borrowing: –)	0.8	− 0.6	− 3.0	− 2.7
9 Structural balance (8−2−3)	7.0	− 7.6	2.0	− 11.2
10 Structural balance adjusted for updated estimate of potential output	7.0	− 12.0	2.0	− 17.5
11 Debt brake ceiling (from 2016: –0.35% of GDP[3])	− 10.2	− 10.6	− 10.6	− 11.0

* For more information, see Deutsche Bundesbank, Public finances, Monthly Report, February 2016, pp 68-69. **1** To be presented once revised by the new Federal Government. **2** Simplified procedure applied: adjusted to the national accounts figures (unchanged from January) published in mid-February 2018. **3** GDP: gross domestic product. Here, this refers to GDP in the year before the budget is prepared.

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serve withdrawals provide no relief for the fiscal balance.

Relief provided by higher tax revenue and lower expenditure

In 2017, revenue (excluding reserve withdrawals) exceeded its target by €8½ billion. This was driven by tax receipts.[14] Turning to other revenue, shortfalls of €2 billion owing to the Bundesbank's lower-than-expected profit distribution were slightly more than offset overall.[15] Going beyond the €3 billion global cut in expenditure to be achieved in the course of implementing the budget, expenditure remained €3½ billion below its overall target. The interest burden accounted for €1 billion of this. However, excluding the (unplanned) premium[16] of €4 billion generated when issuing Federal securities – which pushed down interest expenditure – the interest estimates would have been clearly exceeded. Savings on investment expenditure of €2 billion compared with the budget entitlements were linked, not least, to lower outflows for broadband network expansion and from guarantees. Of the relief concerning transfers (€3 billion in total), €1½ billion was due to the basic allowance for the elderly. Federal states' settlements may be delayed here.[17] These would then be counted against the 2018 budget, meaning to this extent that no relief would be provided overall.

Structural outturn according to debt brake slightly negative, but considerable credit entry in control account

According to data from the Federal Ministry of Finance, the structural outturn for 2017 in the context of the debt brake amounted to -0.1% of GDP. The surplus in the core budget was neutralised by another reserve top-up (no net

14 The unplanned burden stemming from the nuclear fuel tax repayment was offset by lower-than-expected transfers to the EU budget.
15 This was due, not least, to higher grants from the EU.
16 This accounting method harbours the risk of volatile budgetary developments; it would be advisable to change this. See Deutsche Bundesbank, Distortive accounting of premiums and discounts in the Federal budget, Monthly Report, July 2017, pp 43-44. Last year's premium marked a year-on-year increase in expenditure of €2 billion.
17 The 2016 budget outturn, which was deferred until March 2017 in connection with the supplementary budget, factored in delayed settlements of this kind instead.

borrowing).[18] A deficit from financial transactions was more than offset by cyclical relief.[19] In addition, the off-budget entities included under the debt brake recorded a moderate deficit. The structural outturn was thus significantly better than the debt brake ceiling of -0.35% of GDP. At the start of March, central government's control account will once again contain a considerable credit entry (€7½ billion).

Starting position for 2018 budget more favourable

A revised draft central government budget for 2018 will only become the subject of parliamentary deliberations once a new Federal Government is in place. In view of this, a particularly long period of interim budget management is expected this year, during which new (not previously agreed on or legally regulated) spending is tightly restricted. The budgetary situation is likely to continue to improve as a result. The outgoing Federal Government's draft budget of June 2017 envisaged a reserve withdrawal of €8 billion to maintain a budget without additional debt incurrence. Compared with the draft budget, additional revenue of €7 billion was already foreseeable when the November 2017 tax estimate was published. As GDP growth is now forecast to be even stronger than estimated in the Federal Government's projection last autumn, tax revenue could even be revised upwards again. In addition, the global revenue shortfall of €2 billion could, in the absence of budget-burdening measures so far, represent a further buffer. On the expenditure side, many of the expenditure savings made at budget outturn vis-à-vis the budget plans are likely to be maintained, meaning that there should be no trouble achieving the then envisaged global spending cut of €4 billion, together with making additional cost savings in connection with interim budget management. It should therefore be quite possible to once again close the fiscal year without incurring additional debt or drawing on the reserve.

Burdens resulting from new Federal Government's measures

The measures agreed in the coalition agreement between the CDU, CSU and SPD will affect the outlook for 2018 only slightly. The cumulated central government budgetary burdens of €46 billion in the proposed financial framework are clearly concentrated on the latter end of the legislative period. The earmarked funds appear to be based on the room for manoeuvre reported in last summer's financial plan (€15 billion), and also take into account the upward revision of the November 2017 tax estimate and the better-than-expected budget outturn. The latter will push up the refugee reserve. These funds are intended to finance new burdens, although it would seem logical to use them to pay down debt in the budget here, as outlined above. The assumed room for manoeuvre covers, in particular, a reduction in the solidarity surcharge from 2021 onwards, additional expenditure in the areas of education and social welfare, and an extension of temporary central government grants for state and local governments beyond 2018, chiefly those aimed at the integration of refugees. However, the announced additional EU funding payments and significantly higher contributions to the statutory health insurance scheme for persons receiving unemployment benefit II, in particular, were not taken into account as they still seem to be conditional on sufficient funding. Should favourable macroeconomic developments continue, however, it will probably be possible to fund some further measures without additional debt incurrence. Yet, it should be borne in mind that continuing even just a part of the solidarity surcharge probably has to be justified by a particular Federal Government need, which is hard to detect.

18 The way in which changes in reserves are accounted for differs from the European budget rules, compliance with which was intended to be ensured by means of the debt brake. Excluding the reserve top-up, the amount credited to the control account would have been correspondingly higher. However, the use of control account funds is considerably more limited.

19 In the case of the debt brake, the cyclical component determined at budget outturn compared with the figure projected in the budget (2017: -€2 billion) is adjusted using a simplified procedure based on the revision of nominal GDP growth (for more details, see Deutsche Bundesbank, Federal states' cyclical adjustment in the context of the debt brake, Monthly Report, March 2017, p 53). The closing entry in September of the following year is based on the then current GDP data.

Central government's off-budget entities record distinct surplus in 2017 …

According to figures from the Federal Ministry of Finance, central government's off-budget entities (excluding bad banks and other entities that use commercial double-entry bookkeeping) recorded a surplus of €3 billion in 2017,[20] having posted a surplus of €½ billion the year before (amidst continued central government prepayments to the fund to promote municipal investment). Off-budget entities for civil servant pension obligations posted distinct surpluses once again (€3 billion). The precautionary fund for final payments of inflation-indexed Federal securities recorded a surplus of €1½ billion (-€2 billion in 2016). Relevant debt instruments had not expired here, and there was a notable price increase to be offset by central government transfers.[21] By contrast, off-budget entities included in the debt brake (the flood relief fund, the energy and climate fund and the fund to promote municipal investment) all saw deficits of up to just over €½ billion.

… and outlook for 2018 is only slightly less favourable

Central government's off-budget entities are expected to record an overall surplus this year, too. However, there is the forthcoming repayment of an inflation-indexed Federal note (Bobl) to consider, which will burden the relevant off-budget entity when inflation compensation payments are due. In addition, outflows from the fund to promote municipal investment are likely to increase considerably once the rules of the new task area to increase investment in schools have come into force and the federal states have identified their eligible municipalities (with weak financial capacity). Overall, the aggregated figure considered here for central government's off-budget entities is likely to decline somewhat in comparison with 2017.

State government budgets[22]

Historically high surplus for 2017: dynamic tax revenue amid muted spending increase

According to the latest cash data, state government's core budgets concluded 2017 with an exceptionally high surplus of €14 billion. With the exception of North Rhine-Westphalia and Bremen, all of the federal states recorded a surplus.[23] Their finances improved significantly overall, by €5½ billion on the year,[24] making this the highest result since the country's reunification. This was primarily due to the increase in tax revenue (+4%, or just over €10 billion). Considerably increased transfers from public administrations (+8½%, or just over €5½ billion) also played a role, although these were, in part, central government funds to be forwarded to local government. Overall revenue growth totalled just over 4%. By comparison, expenditure growth was more modest at just over 2½%. In particular, personnel expenditure (+4%, or just under €5 billion) and payments to administrations (+3½%, or €3½ billion) – mainly to local government – increased distinctly. However, declines had a dampening effect, especially those in interest expenditure (-6½%, or €1 billion) and other operating expenditure (-1%, following the refugee-related exceptionally sharp increase in 2016), as did the weak development of investment expenditure.

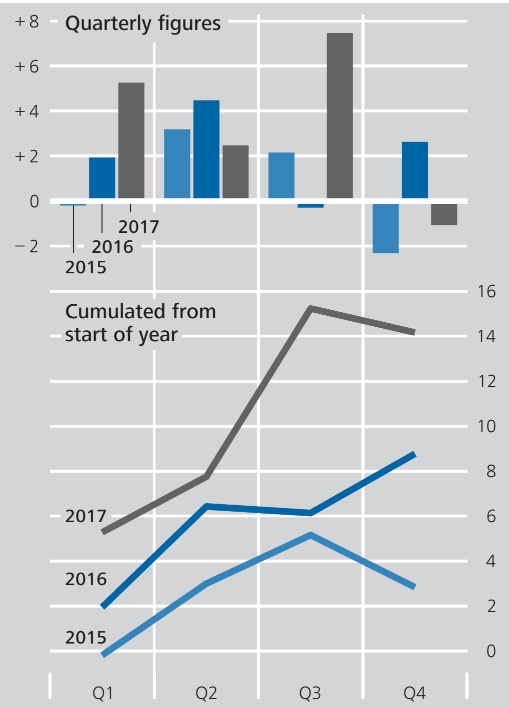
Favourable outlook for 2018 and the medium term

A high surplus can be expected for 2018, too. Payroll employment is likely to continue to grow, other operating expenditure to increase again, and, not least, investment expenditure to rise substantially. At the same time, however, ongoing favourable developments in tax

20 The foundation for funding nuclear waste disposal, which received a one-off payment of €24 billion from power plant operators in 2017, is not included. As an advance payment, this cash receipt retained a neutral balance effect in the national accounts.
21 The balance of this fund is not taken into consideration in the national accounts. The current transfers received are only recorded as central government's interest expenditure, and the redemption premiums financed by this fund do not affect the fiscal balance in the national accounts.
22 The development of local government finances in the third quarter of 2017 was analysed in the short articles in the Bundesbank Monthly Report of January 2018. Only data on the core budgets were available at the time. However, the fiscal balances do not differ substantially from the data now available that include off-budget entities. The data on state government budgets in this quarterly report are based on the monthly cash statistics on the core budgets.
23 Without consolidation assistance, Saarland would also have registered a deficit.
24 The prior-year figure is based on monthly cash statistics. The quarterly results for 2017 are not yet available. In 2016, these included negative closing entries (from special transfers to off-budget entities), with the result that the surplus subsequently stood at €6 billion.

State government fiscal balance*

€ billion



Source: Bundesbank calculations based on monthly data from the Federal Ministry of Finance. * Federal states' core budgets excluding off-budget entities.
Deutsche Bundesbank

revenue are expected, and a further decline in interest payments is to have an alleviating effect. The Federal Ministry of Finance's December 2017 forecast for the Stability Council anticipates further rising surpluses in the next few years, starting from a somewhat lower closing level last year. This is also partly attributable to the increase in central government funds in the context of the reformed financial equalisation system as of 2020. The favourable conditions should be used by state governments not least to contribute to the elimination of remaining local governments' budgetary imbalances. Further state government funds could be counted on here to support any extensive consolidation of local government finances.

In the light of the overall exceptionally good fiscal situation, the majority of the state governments are expected to comply with the debt brake, which comes into force in 2020, without difficulties. Many states are already planning regular net redemptions. In December 2017, by contrast, the Stability Council felt it necessary to extend budgetary recovery procedures, which have been running since 2012, until 2020 in the case of the two highly indebted state governments of Bremen and Saarland. Additional measures were required for Bremen in particular to enable it to adhere to its deficit reduction path. There is still reason to fear that the consolidation efforts of these two state governments will ultimately be insufficient, and that a structurally balanced budget will only be achieved with the help of the high central government budgetary recovery assistance to the tune of €400 million for each state, which is to be paid out on an annual basis from 2020 onwards. Overall, it is important for the individual state governments to ensure that their budgetary outcomes – including off-budget entities – per capita of the population do not remain too far below the federal state average. Otherwise, future budget-burdening nationwide measures, which seem likely given the overall very good economic conditions and will probably be based on the room for manoeuvre of the majority of the state governments under the debt brake, will require immediate significant additional consolidation measures.

Stability Council extends budgetary recovery procedures for Bremen and Saarland and urges further consolidation

Coalition agreement could potentially have extensive impact on state government budgets

The coalition agreement between the CDU, CSU and SPD also contains measures which could affect the budgets of the state governments and their local authorities to a significant but, in some cases, not precisely specified extent, in future. In addition to the ongoing central government transfers intended to relieve the burden of refugee costs, further transfers are planned for the expansion of day care facilities for children in primary education,[25] improved quality of childcare and reduced parental financial contributions, as well as for general

25 In this regard, it has been announced that a legal entitlement will be implemented into the Eighth Book of the Social Security Code (SGB VIII) by 2025. Linking this to assistance for children and young people would push education policy issues into the background.

investment in education (particularly the digitalisation of schools).[26] In addition, education policy coordination is to involve central government and become more strongly institutionalised. It is not yet clear how these measures are to be implemented and financed in concrete terms. For example, a legal entitlement to all-day childcare for children of primary school age would entail considerable investment and personnel costs on the part of the local governments, which are primarily responsible for this. Central government's planned share (€2 billion for the entire legislative period) only appears to cover these costs to a limited extent, possibly because they are mostly to be accrued after the end of this legislative period. Not least the consent of the federal states depends on the concrete implementation of the stated measures. The planned national educational council will play only an advisory role. It remains to be seen whether better nationwide coordination will succeed in this way and whether the state governments will agree to increased central government involvement in the area of education, in view of their autonomy in cultural and educational matters. Although the desired objectives certainly appear worthy of support, an increased blurring of the lines of responsibility for financing and various tasks between central and state government would be problematic as it would entail the risk of inefficiencies, as past experience has shown.

Social security funds[27]

Statutory pension insurance scheme

2017 result significantly better than that of previous year

According to preliminary figures, the statutory pension insurance scheme posted a small surplus in 2017. The result was thus significantly better than in the previous year (+€2½ billion) and better than estimated in central government's pension insurance report of autumn 2016 (+€2 billion). The reserve was above the statutory upper limit once again, at 1.6 times monthly expenditure. Revenue rose by a total of 4½% as a result of the ongoing favourable employment and wage developments, but also due to the phasing-out of a temporary reduction of the central government grant. By contrast, expenditure rose at a somewhat slower pace (+3½%). Pensions saw an annual average increase of 3½% on the previous year. However, the growth in the number of pensions was somewhat more subdued.

Stable result possible for 2018 in spite of contribution rate reduction

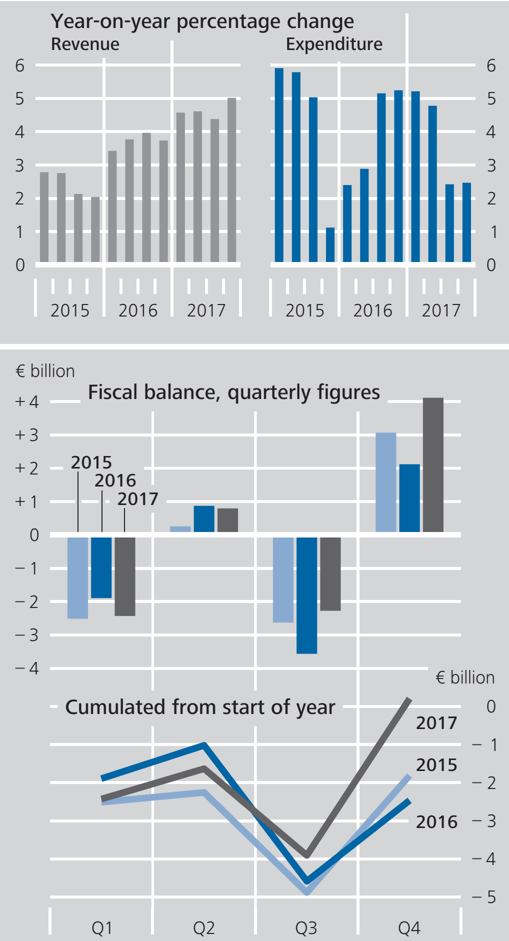
At the start of the year, the contribution rate was lowered by 0.1 percentage point to 18.6%. However, revenue will be bolstered by positive labour market developments and marked wage increases. Expenditure growth and the expected mid-year pension adjustment are likely to be lower overall than in 2017. As things stand, a virtually unchanged result appears likely on the whole, whereby the upper limit for the reserves is expected to be distinctly exceeded once again.

Statutory pension insurance scheme only experiencing interim peak, however

However, the finances of the statutory pension insurance scheme are currently only experiencing an interim peak. In the medium term, as more people enter retirement and employment loses momentum, partly due to the fact that birth rates have been declining for decades, the reserves are set to be depleted. Central government's current pension insurance report states that contribution rate increases can be expected from 2023 onwards. Owing to demographic developments, the statutory pension insurance scheme as a whole will be put under considerable financial pressure up to 2035 and will still feel perceptible strain thereafter. It is therefore particularly important to take the long-term prospects into account when making decisions about benefit expansions. If the contribution rate, the statutory retirement age,

26 Financial assistance in accordance with Article 104c of the German Basic Law, which was introduced in 2017 for financially weak local governments, is to be extended to all local governments.
27 The financial development of the public long-term care and statutory health insurance schemes in the third quarter of 2017 was analysed in the short articles of the December 2017 Monthly Report. These are the most recent data available.

Finances of the German statutory pension insurance scheme



Source: German statutory pension insurance scheme (Deutsche Rentenversicherung Bund). Preliminary quarterly figures. The final annual figures generally differ from the total of the reported preliminary quarterly figures as the latter are not revised subsequently.

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the pension level and the central government grant all paint a consistent picture here, this could not only strengthen confidence in the statutory pension insurance scheme but also reduce uncertainty as regards financial security in old age. Long-term projections could also reveal intergenerational distribution effects and provide a sounder basis for pension policy decision-making.

More comprehensive old-age provision proposed in coalition agreement

Various benefit increases have been outlined in the coalition agreement between the CDU, CSU and SPD. For instance, pensions for persons with reduced earning capacity are to be increased and the recognised child-raising periods for families with three or more children born before 1992 extended by a third year. Pension income is also to be raised for persons with low pension entitlements insured on a long-term basis, according to their needs. In cases of reduced earning capacity, pension provisions are to be improved by means of longer non-contributory supplementary periods.[28] Here, adequate provisions are, in principle, a key component of the statutory pension insurance scheme. However, an expansion of benefits would distinctly boost incentives for early retirement, which would make it even more important to prevent the system from being abused. A further increase in "mothers' pensions" ups the spending pressure on the pension insurance scheme; however, additional expenditure is constrained by linking this to the number of children. A threshold of 35 years, made up of contribution periods, child-raising periods and care-giving periods, has been agreed for basic pensions, with contribution periods including periods of claiming unemployment benefit I, for example. In view of the rising retirement age, 35 years seems rather low, but the planned means-testing would limit additional expenditure. However, the intended further-reaching exemption of owner-occupied housing[29] would entail additional discrimination and distortions.

Define non-insurance-related benefits and fund them using tax revenue

There are no separate pension contributions to finance the increase in mothers' pensions and basic pensions. Funding these from contribution receipts would therefore infringe the principle of equivalence, and could possibly result in undesirable distributional effects up to the maximum level of earnings subject to contributions on account of the proportional tax re-

28 The non-contributory supplementary periods to be heeded when calculating pensions are to be extended to the statutory retirement age (currently 65 years and seven months) in the short term, and then to 67 years when this change comes into effect.
29 It appears that this is intended to apply even in cases where unemployment benefit II or social assistance are received.

gime.[30] In order to increase the transparency of the pension insurance scheme and to avoid shuffling funds to and from the central government budget depending on the cash balance, it would make sense, in principle, to define the benefits not covered by contributions and to direct central government grants towards them. This would also make the pursued objectives, as well as their costs and funding, more comprehensible.

Compulsory insurance for self-employed persons could dampen contribution rate rise over a longer transitional period

Insurance under the statutory pension insurance scheme is to become compulsory for self-employed persons, with an option to "opt-out" if they have made sufficient old-age provisions elsewhere. Including self-employed persons in the statutory pension insurance scheme would directly result in additional revenue, but the resulting additional expenditure would only rise after some time. On account of the given legal regulations, the contribution rate rise would be dampened for a transitional period. However, the statutory pension insurance scheme's demographic problem cannot be permanently resolved by expanding the pool of insured persons.

Stabilisation of pension level until 2025

In addition to the above measures favouring subgroups of pensioners, it is envisaged to both stabilise the pension level measured against the standard pension (assuming an average income over 45 contribution years) at the current value of around 48%, and to restrict the contribution rate to 20% (present rate: 18.6%) until 2025. On account of the very favourable labour market developments, it has been possible to keep additional expenditure related to the stabilisation of the pension level to a limit, according to central government's latest pension insurance report. With no new measures that have a detrimental impact, the contribution rate would be expected to exceed the 20% mark in around 2025, as things stand. However, the contribution rate could now rise sooner and more steeply on account of the envisaged benefit increases, and additional tax revenue may ultimately be necessary to ensure adherence to the upper limit.

Maintaining pension level and upper limit for contribution rate long-term …

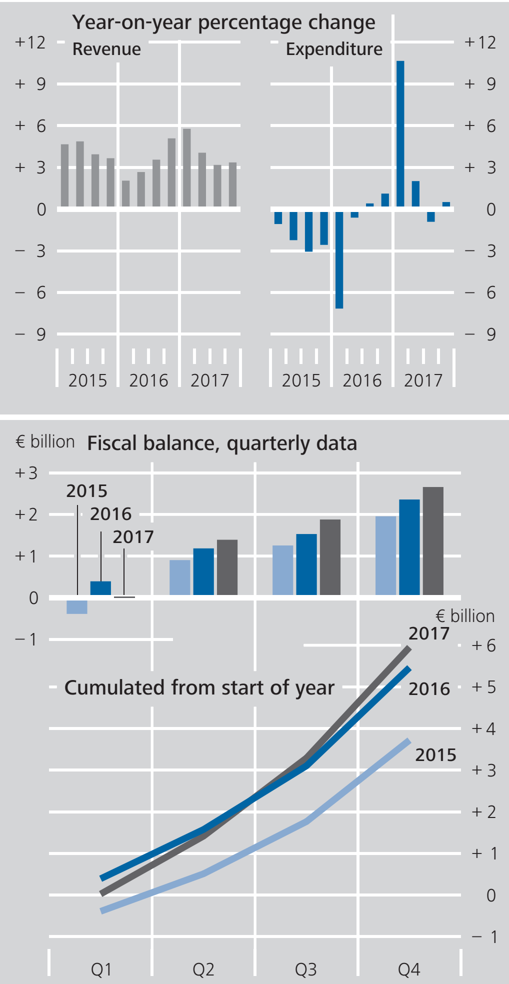
A pensions commission is to develop proposals for limits for the long-term contribution rate and pension level in particular, for the period after 2025. Were the pension level to remain unchanged beyond 2025, this would result in high and increasing additional expenditure over time. If the rise in the contribution rate were to be restricted simultaneously, this would have to translate into changes to the statutory retirement age, to level-independent benefits (such as surviving dependents' pensions) and/or to the central government grant. Against a backdrop of increasing life expectancy, arguments in favour of increasing the retirement age include, *inter alia,* the possibility of stabilising the relationship between the contribution period and the pension-drawing period, and increasing employment potential.[31]

… would require marked tax increases even if pension age increases

Additional central government funds for pension expenditure would further augment the increase in central government grants. Transfers to the statutory pension insurance scheme already account for almost three tenths of expenditure in the central government budget, and steep growth is already anticipated here without expansions. Measured in terms of GDP (which essentially constitutes the tax base), central government grants are set to increase disproportionately because they follow per capita earnings for the most part (which, unlike GDP, are not dampened by the demographic challenges posed by employment).[32] Not least to at least mitigate an increased tax burden, further increasing the statutory retirement age for age groups that are currently close to retire-

30 For more on the adequacy of funding retirement benefits for child-raising periods with tax revenue, see Gutachten des Sozialbeirats zum Rentenversicherungsbericht 2013 (Bundestags-Drucksache 18/95). Increasing benefits for people claiming pensions for reduced earning capacity represents an expansion of insurance cover, meaning that raised contribution rates certainly seem to be an appropriate means of financing.
31 In principle, it would make sense to adjust the calculation of the standard pension to factor in the claims arising from extended employment periods. For more information, see Deutsche Bundesbank, Excursus: longer-term pension developments, Monthly Report, August 2016, pp 68-77.
32 They also rise much more sharply than contribution receipts. Against a backdrop of rising pension contribution rates, contribution receipts and large parts of the central government funds increase to the same extent.

Finances of the Federal Employment Agency*



Source: Federal Employment Agency. * Federal Employment Agency core budget including transfers to the civil servants' pension fund.
Deutsche Bundesbank

ment, even after 2030, should not be categorically ruled out. As is the case in current law, a certain reduction in the pension level which can be offset by private provisions still appears equally sensible.

Federal Employment Agency

High surplus for 2017

The Federal Employment Agency's core budget[33] was €6 billion in surplus in 2017, thus slightly exceeding the already high level of the previous year. The result was, in fact, reduced by a special allocation to the pension fund totalling just over €½ billion, whereas it had been increased by a positive one-off effect (€½ billion)[34] in the previous year. The budget estimate (surplus of €1½ billion) was substantially exceeded once again. The free reserves for operational activities increased at the end of 2017 to €17 billion.[35]

Further decline in unemployment benefit spending

Amid robust growth in contributions, revenue rose by a total of 4%. At 3%, the increase in expenditure lagged distinctly behind. Excluding the aforementioned special effects, spending would actually have fallen slightly. In particular, payments for unemployment benefit continued to decline and spending on active labour market policy measures was at around the same level as the previous year.

High surplus likely for 2018, too

The budget plan envisages a marked decline in the surplus to €2½ billion in 2018. Sharp growth of almost a quarter, or €1½ billion, on the year is expected once again for active labour market policy measures. From the current perspective, unemployment benefit spending also looks set to rise due to an increase in the number of recipients and the per capita rates. However, in the light of the anticipated favourable labour market developments, which are also projected by the Federal Government in the current Annual Economic Report, these estimates seem significantly overstated. A substantial share of the deterioration (€1½ billion) in the budget position is due to an additional *ad hoc* special allocation to the civil servants' pension fund,[36] without which the surplus could have been expected to rise once more, as things stand.

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33 Excluding the pension fund, ie the transfers reduce the fiscal balance.
34 In 2016, the supplementary pension scheme of central and state government (Versorgungsanstalt des Bundes und der Länder, or VBL) had reimbursed the additional payments charged in previous years. This resulted first and foremost in subdued administrative expenditure by the Federal Employment Agency. See Deutsche Bundesbank, Public finances, Monthly Report, May 2016, p 68 and p 73.
35 Further reserves include the insolvency benefit and winter compensation reserve (totalling just over €2 billion) and a reserve of €6½ billion in the pension fund.
36 As a result of the special allocation, transfers are to end in 2028 rather than in 2048, as originally planned. In addition, from 2018, the rate of regular annual transfers was raised from 80% to 96.6% of civil servants' pensionable pay (which, apart from the basic salary, may include family allowances as well as benefits and other remuneration deemed pensionable).

Marked contribution rate reduction appropriate

In the light of the forecast positive labour market development at present, the Federal Employment Agency's financial situation is set to remain very positive for the next few years. Surpluses are expected to increase and reserves to grow strongly as a consequence. Against this backdrop, plans to reduce the contribution rate are logical. If the surpluses are cyclical, however, they should not be available for use. Yet even if this is taken into account, the reduction announced in the coalition agreement (0.3 percentage points) seems rather moderate.