Public finances*

General government budget

Fiscal balance broadly stable and …

Germany's public finances are currently in comparatively good shape, and the very high debt ratio is starting to come down. Supported by generally favourable underlying conditions, small surpluses were recorded in both 2012 and 2013. As things stand today, a roughly balanced general government budget is also expected for 2014 and 2015. Following a slight cyclical burden on average in 2013, favourable cyclical factors are forecast until 2015. Furthermore, interest expenditure could decrease due to a falling average interest rate and a possible debt reduction in absolute terms. By contrast, various fiscal policy measures are set to result in budgetary burdens overall. For instance, additional funds are earmarked for transport infrastructure, childcare, education and research. However, the most significant burdens in financial terms are the selective benefit increases in the statutory pension insurance scheme, which include pensions paid for periods spent raising children (mothers' pensions) and upon early retirement (full pension without actuarial deductions at 63) in particular. Nevertheless, the legal provisions limiting the amount of reserves that the statutory pension insurance scheme is allowed to hold could lead to the pension contribution rate being cut, which would accelerate the already foreseeable depletion of the scheme's financial reserves.

… debt ratio declining

While debt, which totalled 78.4% of nominal gross domestic product (GDP), was still very high at the end of 2013, it was already considerably lower compared with the year before. It fell further to 77.3% in the first quarter of 2014, with the debt ratio likely to continue to decline during the course of the year. With a close-to-balance general government budget, expected nominal GDP growth in the debt ratio's denominator will push it down relatively quickly. As things currently stand, this comes on top of the continued portfolio reduction at government-owned bad banks. The increases in debt brought about by further payments agreed as part of the euro-area financial assistance mechanisms, on the other hand, are less significant.[1]

Medium-term surpluses projected for general government

The Federal Finance Ministry's latest medium-term projection forecasts general government surpluses in the order of ½% of GDP from 2016 onwards.[2] The debt ratio is expected to be reduced rapidly, albeit not enough to bring it below the 60% limit by the end of the current medium-term forecast horizon (2018: 65%). The medium-term objective of a structural deficit ratio of no more than ½% of GDP is forecast to be met with a substantial margin of around 1 percentage point. However, the cyclical adjustment procedure used for EU budgetary surveillance appears to paint too rosy a picture of the structural budgetary position, and with it the safety margin for the medium-term objective.[3]

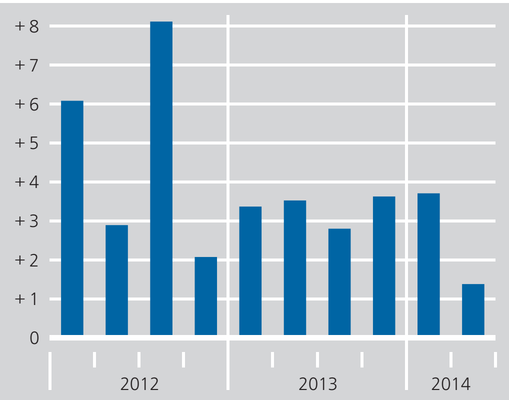
Slight easing of fiscal stance planned, …

The comparatively stable structural fiscal balance can be attributed in part to the slight easing of the fiscal stance being accompanied by further reductions in interest expenditure. It is sometimes recommended that Germany pursue a more expansionary fiscal policy, particularly by means of increasing government investment on an unfunded basis, and that it should further reduce the safety margins vis-à-vis the deficit ceilings. This should, *inter alia,* strengthen growth potential. However, such a

* The section entitled "General government budget" refers to data contained in the national accounts and the Maastricht ratios pursuant to the European System of Accounts (ESA) 1995. For all aggregates, this will be replaced by the revised ESA 2010 from September 2014. The subsequent reporting on the budgets of the various levels of government and the social security funds is based on the figures as defined in the government's financial statistics (which are generally in line with the budget accounts).
1 General budgetary risks remain, not least as a result of uncertainty in the global and European arenas.
2 See Federal Ministry of Finance, Press Release No 32 of 10 July 2014.
3 See also Deutsche Bundesbank, Public finances, Monthly Report, May 2014, pp 66-81, particularly p 67.

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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laudable objective could well be achieved by initiating structural shifts or changing policy priorities, without further easing the fiscal stance.

… but not advisable

With regard to its pattern of expenditure, the Federal Government has, to date, clearly focused additional spending on extending pension benefits, while devoting considerably fewer additional funds to government investment. This appears counterproductive in terms of strengthening growth potential. Given the extremely favourable conditions for public finances in Germany and the ongoing budgetary risks, it would, in fact, be advisable to pursue a more ambitious budgetary policy rather than easing the fiscal stance. This would allow the debt ratio to be brought below the 60% threshold more quickly, helping to lessen the impact, in particular, of the demographic challenges that lie ahead. Furthermore, it would appear advisable to make the most of the currently generally favourable auspices and push ahead more energetically with the budget consolidation still required in many cases at various levels of government. Factoring in very tight safety margins vis-à-vis the strict national deficit ceilings would be problematic, as it carries the risk that procyclical corrections may become necessary if the situation takes a turn for the worse. This is also indicated by information supplied by the recently established Independent Advisory Board of the Stability Council *(Beirat des Stabilitätsrates),* which regularly takes a stand on the outlook for public finances and compliance with European requirements.[4] Experience shows the importance of prudent budgetary policy in good times in order to have scope for manoeuvre if the environment deteriorates. This is especially true of Germany as the euro area's stability anchor.

Budgetary development of central, state and local government

Tax revenue

Subdued tax revenue growth in 2014 Q2 …

Tax revenue[5] in the second quarter of 2014 was up by a mere 1½% on the year (see chart above and the table on page 71). Primarily responsible for this slowdown were court orders, which were issued by Hamburg Fiscal Court after a complaint was lodged by nuclear power plant operators. These ruled that the operators should be provisionally refunded for nuclear fuel tax payments made since 2011.[6] Without these repayments, revenue would have risen by 3%. Gross wage tax receipts saw an increase of 4%, while the stagnation of child benefit (which is deducted from receipts) resulted in wage tax revenue rising even more steeply in terms of actual cash inflow. The slight reduction in refunds to employees also strengthened the continued dynamic growth in receipts from assessed income tax. By contrast, revenue from corporation tax and investment income tax fell. However, revenue from these taxes tends to be highly volatile and, therefore, as things currently stand, the overall growth expected for these types of tax in the official tax estimate

… primarily due to one-off effects

4 See Independent Advisory Board of the Stability Council, First statement on compliance with the upper limit for the structural general government fiscal deficit pursuant to section 51 (2) of the Budget Principles Act (Haushaltsgrundsätzegesetz), 21 May 2014.
5 Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the quarter under review.
6 Court orders issued by Hamburg Fiscal Court on 11 April 2014 (case number 4 V 154/13).

Tax revenue

Type of tax	H1 2013 € billion	H1 2014 € billion	H1 2014 Year-on-year change € billion	H1 2014 Year-on-year change %	Estimate for 2014[1,2] Year-on-year change %	Q2 2013 € billion	Q2 2014 € billion	Q2 2014 Year-on-year change € billion	Q2 2014 Year-on-year change %
Tax revenue, total[2]	277.5	284.5	+ 7.0	+ 2.5	+ 3.4	142.5	144.4	+ 2.0	+ 1.4
of which									
Wage tax	75.3	79.8	+ 4.5	+ 6.0	+ 6.0	38.8	40.8	+ 1.9	+ 5.0
Profit-related taxes[3]	49.0	48.4	− 0.6	− 1.3	+ 0.2	25.6	24.5	− 1.2	− 4.5
Assessed income tax	21.8	23.8	+ 1.9	+ 8.9	+ 7.5	11.1	12.0	+ 0.9	+ 7.9
Corporation tax	11.4	10.7	− 0.8	− 6.7	− 7.5	5.4	5.1	− 0.4	− 6.6
Investment income tax[4]	15.7	13.9	− 1.8	− 11.4	− 5.9	9.1	7.4	− 1.7	− 18.4
Turnover taxes[5]	96.3	99.7	+ 3.4	+ 3.5	+ 3.3	47.1	49.2	+ 2.0	+ 4.3
Energy tax	14.1	14.5	+ 0.4	+ 2.8	+ 0.2	9.5	9.9	+ 0.4	+ 4.2
Tobacco tax	5.6	6.2	+ 0.5	+ 9.6	+ 3.5	3.5	3.7	+ 0.2	+ 5.8

Source: Federal Ministry of Finance and Bundesbank calculations. **1** According to official tax estimate of May 2014. **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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still appears to be within reach. Revenue from consumption-related taxes increased considerably (+4%), but these are also subject to large intra-year fluctuations.[7]

Robust growth for year as a whole

According to the official tax estimate from May, tax receipts for 2014 as a whole are expected to rise by 3½% (including local government taxes). This growth primarily reflects underlying economic conditions. Fiscal drag will also lead to additional receipts in net terms, while legislative changes (most notably the increase in the basic income tax allowance and the gradual changeover to downstream taxation of pensions) will slightly reduce revenue overall. Tax refunds due under the ruling by the European Court of Justice on the taxation of dividends paid to EU/EEA companies are slowing anticipated revenue growth.[8] Overall, revenue developments have so far been somewhat less favourable than originally forecast. This is mainly attributable to the aforementioned nuclear fuel tax refunds, which have not yet been included in the official tax estimate and will dampen revenue growth for the year as a whole by around ½ percentage point.[9] At the same time, there is a high degree of uncertainty, not least due to the sometimes sharp fluctuations in receipts from profit-related taxes.

7 Fluctuations in turnover tax revenue can stem, in particular, from the sometimes large refunds or supplementary payments that are due when advance payments made during the course of the year deviate from the final amount of tax payable. Various one-off factors relating to payment shifts in the course of the year were likewise recorded for other excise taxes in the second quarter, eg the transfer of responsibility for collecting motor vehicle tax from the state government to the central government customs authority.
8 Ruling of 20 October 2011 on case C-284/09.
9 Overall, revenue from nuclear fuel tax charged from 2011 to the end of 2014 would have likely totalled around €5 billion. If a supreme court decision is issued in 2014 and it subsequently becomes necessary to also refund payments made by nuclear power plant operators who were not involved in the complaint lodged at Hamburg Fiscal Court, the risk to revenue growth will be 1 percentage point.

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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Central government budget

Surplus unchanged in 2014 Q2 despite nuclear fuel tax repayments

Central government recorded a surplus of €1 billion in the second quarter of 2014, as it had done one year previously. Revenue and expenditure were each down by 1% (-€¾ billion) compared with spring 2013. As a result, tax revenue fell by 1% (-€½ billion). This was primarily due to the repayment of nuclear fuel tax revenue totalling €2 billion. However, deductions from tax revenue for transfers to the EU budget were also up on the year again (+€½ billion). Revenue from asset sales, which was most notably affected by declining privatisation proceeds, fell by €½ billion. Interest payments, in particular, had an alleviating effect on expenditure once again, as they were €2 billion down on the year – not least due to lower transfers of provisions to the special fund for the redemption of inflation-indexed Federal securities. By contrast, a rise was recorded for payments to the social security funds (+€1 billion). Had the further (and greater) cut in payments to the health insurance fund – which entered into force retroactively in the summer – been factored in, these transfers would have risen only slightly.

2014 budget tighter than in previous years

Parliamentary deliberations on the central government budget for 2014 were concluded in June. Compared with the draft submitted by the new Federal Government in March, net new borrowing remained unchanged at €6½ billion. Expenses resulting from the aforementioned court ruling regarding nuclear fuel tax appear to have been recorded as a global revenue shortfall. However, the estimated burdens in this regard only went up by €1½ billion compared with the government's draft budget, meaning that the burden increase is smaller than the level of refunds. Consequently, an unexplained revenue-enhancing item was included, with it being reported that expected higher tax revenue vis-à-vis the official tax estimate[10] played a crucial role here. In particular, budgeted figures for interest expenditure were cut by just over €1 billion, while those for calls on guarantees, unemployment welfare benefit (II) and defence expenditure were each cut by just under €½ billion in order to offset the new expenses – including those associated with the planned increase in civil servant salaries. The previously envisaged global additional expenditure of €½ billion on plans relating to childcare, education and research that had not yet been specified in March was also factored out, with specific budget increases for the ministries affected falling short of this value. Despite the fact that interest rates, which are currently very low, could still provide some relief vis-à-vis the budget plans, the 2014 budget appears much tighter overall than the budgets adopted in previous years. In the event of significant further shortfalls, eg pertaining to the nuclear fuel tax, or failure to achieve estimated cost savings (as may well be the case for un-

10 The tax estimate, which generally serves as the basis for budget plans, had initially still led to a reduction of just over €½ billion in budgeted tax receipts during final deliberations.

Central government's medium-term fiscal planning from 2014 to 2018 and structural net borrowing under the debt brake

€ billion

Item	Actual 2012	Actual 2013	Target 2014	Draft 2015	Fiscal plan 2016	2017	2018
Expenditure[1]	306.8	307.8	296.5	299.5	310.6	319.9	329.3
of which							
Investment[2]	27.6	24.8	25.5	26.1	27.2	27.9	27.2
Revenue[1, 3]	284.3	285.7	290.0	299.5	310.6	319.9	329.3
of which							
Tax revenue[1]	256.1	259.8	268.2	278.5	292.9	300.7	311.8
Net borrowing	22.5	22.1	6.5	–	–	–	–
plus cyclical component[4]	– 6.4	– 3.9	– 4.9	– 1.7	– 1.4	– 0.6	–
plus balance of financial transactions[5]	– 7.4	– 4.6	– 2.9	1.4	0.5	0.5	– 0.5
Fiscal balance of relevant off-budget entities							
Energy and Climate Fund	0.2	– 0.1	– 0.1	–	.	.	.
Reconstruction Assistance Fund (2013 flood)	–	7.4	–	–	.	.	.
Structural net borrowing	8.5	6.2	– 1.2	– 0.2	.	.	.
as a percentage of GDP[6]	0.3	0.2	– 0.0	– 0.0	– 0.0	– 0.0	– 0.0
Memo item							
Structural net borrowing[7]							
Upper limit according to Federal Ministry of Finance	39.4	33.2	26.6	18.1	9.9	10.3	10.6

1 After deducting supplementary central government grants, shares in energy tax revenue, compensation under the 2009 motor vehicle tax reform and consolidation assistance from 2011 onwards, which are all remitted to state government. **2** Excluding participating interests in the ESM. **3** Including proceeds from coin seigniorage. **4** Figures for 2012 and 2013 are taken from the 2013 budgetary accounts. For 2014 to 2018, as stated in central government's 2014 spring forecast. **5** As defined for the respective fiscal year. **6** Nominal GDP in the year preceding the drafting of the budget (data for fiscal plan years as stated in 2014 spring forecast). **7** The deficit reduction path from 2011 to 2015 is based on the June 2010 estimate of the starting structural deficit value for 2010 (2.2% of GDP) and a reduction of 0.31% of GDP per year.

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employment welfare benefit (II), for instance), it is possible that the planned deficit target will not be met.

In line with benchmark figures, 2015 draft budget envisages no net borrowing

At the beginning of July, the Federal Cabinet approved the draft central government budget for 2015. In line with the benchmark figures adopted in March, the central government budget envisages no net borrowing for the first time since 1970. Compared with the benchmark figures, the budgeted amount for education was raised by just over €1 billion and, in return, the corresponding provisional funds were deducted from the departmental budget "General financial administration". In particular, the higher amounts budgeted for personnel expenditure (in line with the increase in civil servants' remuneration, which has now been definitively set forth) are offset by a downward revision of the interest expenditure estimate.

Compared with the budget plans for 2014, the deficit will shrink by €6½ billion. A major factor contributing to this is the absence of the €4½ billion in capital injected into the European Stability Mechanism (ESM) in 2014. In light of underlying favourable economic developments, a significant rise in tax revenue is expected for 2015. Taking into account the global revenue shortfall in the 2014 budget relating to the nuclear fuel tax refunds, the increase comes to just over €11½ billion. However, this coincides with numerous expenses. For example, the implementation of parts of the coalition agreement alone will lead to additional spending of €3 billion, primarily on education and research, supporting local authorities with integration assistance and on investment in transport infrastructure. Additionally, several relief measures that were still reflected in the 2014 budget (eg reclaiming flood assistance fund resources and cutting transfers to the health insurance fund) were either no longer budgeted for or were budgeted for on a reduced scale. Furthermore, the total grant to the statutory pension insurance scheme is

Significant increase in tax revenue almost entirely cancelled out by additional expenditure

€2 billion higher (in line with the adjustment rules), while appropriations for personnel expenditure have been increased by €1 billion. Finally, the figures budgeted for certain social benefits, eg the basic allowance for the elderly and the childcare supplement, were also raised significantly. On balance, the additional burdens amount to just over €10 billion, thus largely offsetting the increase in tax revenue.

Structural deterioration of budget balance envisaged

The improvement in the budget balance is largely attributable to the absence of the ESM capital injection, which is classified as a financial transaction. At the same time, the cyclical burden included in the calculations is set to fall by €3 billion. Overall, compared with the 2014 budget plans, this will result in a €1 billion deterioration in the structural balance pursuant to the debt brake, with the structural surplus sinking to €¼ billion. With respect to this surplus, however, it must be noted that the government is still using a calculated cyclical burden of just over €1½ billion while, *inter alia,* important indicators such as capacity utilisation and unemployment already appear to point towards a fairly normal economic situation today; this is likely to have already been exceeded by a considerable margin in light of the underlying favourable macroeconomic developments in 2015.[11] Thus, in structural terms, cyclical factors should actually provide relief for the central government budget. Furthermore, the zero-deficit budget once again envisaged for the flood assistance fund (an off-budget entity), which is to be included in the calculations under the debt brake, does not appear likely, as significant outflows are expected in 2015. While a balanced core budget will thus be achieved overall, the budget plans indicate another deficit in structural terms when taking into account off-budget entities. Even so, several budgeted figures appear to have been calculated cautiously, which means that a better result cannot be ruled out.

Planned loosening of fiscal policy up to 2018 not advisable

The financial plan up to 2018, which was adopted alongside the 2015 draft budget, aims for a balanced budget with no net new borrowing throughout the entire period as set out in the coalition agreement. However, compared with the financial plans adopted by the previous government in summer 2013, which saw growing surpluses culminate in a surplus of €9½ billion in 2017, what has now been announced constitutes a significant loosening of fiscal policy. Structural consolidation is no longer planned. Should the economic situation deviate from central government's estimation and be classified as increasingly favourable over the forecast period, the safety margin vis-à-vis the borrowing limit will gradually erode, while risks, in connection with the debt crisis, for example, will continue to loom. This and the significant impending burden of demographic change also make it appear appropriate to focus more on scaling back central government's high level of debt.

Renewed moderate surplus for off-budget entities in 2014 Q2

Central government's off-budget entities (excluding bad banks) recorded a surplus of €½ billion in the second quarter of 2014, compared with a figure of €2 billion in the same period last year. At that time, the Financial Market Stabilisation Fund (SoFFin) had posted a surplus of €1½ billion following repayment of the final portion of its silent participation in Commerzbank. On the other hand, unlike in 2013, there were no inflation-indexed central government debts to pay off. However, as the central government transfers to the special fund established to settle these redemption burdens were considerably smaller due to the lower rate of inflation, an improvement of only €½ billion was recorded on balance. Furthermore, outflows from the assistance fund set up in summer 2013 to tackle flood damage were still very modest. However, the fund is expected to record considerably higher outflows during the latter six months of 2014, not least because of central government plans to reclaim €1 billion from the fund for its budget. Nevertheless, surpluses in the precautionary reserves and the

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11 See also Deutsche Bundesbank, Outlook for the German economy – macroeconomic projections for 2014 and 2015 and an outlook for 2016, Monthly Report, June 2014, p 11ff.

Investment and Repayment Fund (as a result of the high transfer of Bundesbank profit) for the year as a whole should lead to central government's off-budget entities posting a surplus at the end of 2014. This is likely to be significantly lower than in 2013, when a positive balance of almost €11 billion was recorded on account of the advance payments to the flood assistance fund and the repayment of capital assistance to SoFFin.

State government budgets[12]

2014 Q2: deterioration again due to substantial rises in expenditure

In the second quarter of 2014, as was the case at the start of the year, state government core budgets deteriorated in year-on-year terms. Consequently, the surplus fell substantially by €2 billion to €1 billion. Revenue increased only slightly (+½%, or +€½ billion). A 2% rise in tax revenue (€1½ billion) contrasted with an overall decline in other receipts. Despite a further significant drop in the interest burden (-€½ billion), overall expenditure was up by 3½% (+€2½ billion). Transfers to public administrations (especially local government), meanwhile, grew sharply by €2 billion. Despite the considerable hike in pension benefits, the increase in personnel expenditure was more subdued (+2½%, or +€½ billion).

Further improvement not likely for year as a whole, but surpluses possible in the medium term

Given the slightly weaker intermediate results, the Federal Ministry of Finance expects the overall deficit of the state government core budgets to remain largely unchanged at €2 billion for 2014.[13] The further significant increase in tax revenue, coupled with lower interest expenditure, is forecast to be offset by growing expenditure on staff and local authorities. Surpluses are then expected to rise gradually to €3 billion in subsequent years up to 2018. While the somewhat accelerated growth in tax revenue is accompanied not least by a temporarily lower increase in transfers to local authorities, this also coincides with a substantial renewed rise in the interest burden. Given the assumed smooth development of the economy and in light of the further relief for state governments announced by central government (particularly in the education sector), the relatively rosy picture that has been painted appears by all means achievable, even if greater improvement would be desirable overall owing to the stringent debt brake requirements enshrined in the German Basic Law.

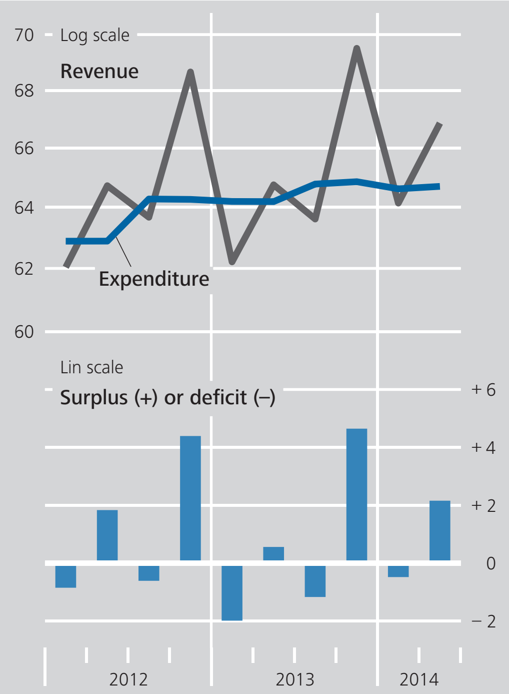
Ongoing very strained financial situation not exclusive to federal states in receipt of consolidation assistance

The relatively favourable overall situation is obscuring the significant structural tensions that are ongoing in a number of federal states. It still seems necessary to promptly enshrine the debt brake, as laid down in the Basic Law, in each federal state's legislation in order to better assess respective needs for consolidation. In its meeting at the end of May, the Stability Council concluded that the states in receipt of consolidation assistance (Berlin, Bremen, Saarland, Saxony-Anhalt and Schleswig-Holstein) complied with the upper limits of the structural deficit reduction path agreed for the period up to 2019 last year as well. However, the interim evaluation of the multi-year restructuring plans was less favourable, particularly for Bremen and Saarland. Above all, the Stability Council is calling for the planned consolidation to be fleshed out further. But there is still a need for action in reducing structural deficits in other states, too. These include Hesse, Rhineland-Palatinate and North Rhine-Westphalia in particular. At the start of July, the Constitutional Court of North Rhine-Westphalia dismissed the heavily muted increases in civil servant salaries for the largest pay grades for 2013 and 2014 as unconstitutional; as such, further substantial budgetary burdens are on the horizon. Additional pay increases may be required in Bremen as well, as similar rules were adopted there. The decoupling of civil servants' pay from wage developments in the overall economy over a period of several years, which has been the case in Rhineland-Palatinate for some years

12 The development of local government finances in the first quarter of 2014 was analysed in greater detail in the short articles in the Bundesbank's July Monthly Report. These are the most recent data available.
13 See Federal Ministry of Finance, Press Release No 32 of 10 July 2014.

Finances of the German statutory pension insurance scheme

€ billion, quarterly data



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

now and is being planned in Hesse, is also fraught with legal risk. The east German states, by contrast, will be heavily affected by the phase-out of special supplementary central government grants by 2020. Against this background, many federal states are still faced with the need to subject the tasks that they perform to scrutiny, and to increase efficiency.

Social security funds[14]

Statutory pension insurance scheme

Financial improvement continues in 2014 Q2

The statutory pension insurance scheme recorded a surplus of just over €2 billion in the second quarter of 2014, which was €1½ billion higher than one year previously. The key factors behind this considerable improvement were favourable developments in contribution receipts (up by almost 4%) on the one hand and, on the other, the continued moderate growth in expenditure (just under 1%) due to the only slight rise in pension numbers and the relatively low pension increase that came into effect on 1 July 2013. At €1½ billion, the surplus for the first six months of 2014 as a whole constituted a year-on-year increase of €3 billion.

Despite reform-related expenses, surplus for year as a whole and …

A considerable deterioration in the financial situation is expected in the second half of 2014. First, the pension increase that took effect on 1 July 2014 was significantly higher overall (+1.67% in western Germany and +2.53% in eastern Germany). This is compounded by the fact that the benefit increases introduced in mid-2014, which apply to child-rearing periods, particularly long-term insurees and disabled persons in particular, are generating appreciable additional expenditure. Nevertheless, based on central government's cost estimates for additional benefits, a surplus could still be recorded for the year as a whole. Overall, the reserves could continue to rise above the statutory upper limit of 1.5 times the scheme's monthly expenditure. If the contribution rate were to remain unchanged, it would then be expected that the reserves would remain above this upper limit until the end of 2015, thus rendering it necessary to lower the contribution rate pursuant to the statutory adjustment provision.

… contribution rate cut for 2015 feasible

Periods of unemployment counted as contribution years for full pension at 63 recently subjected to restrictions

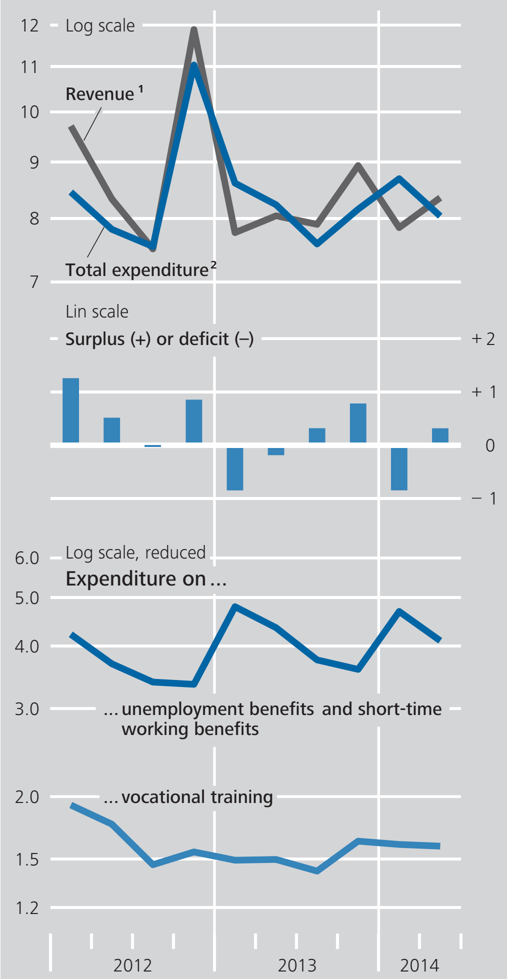
The benefit increases introduced by the latest pension reform were diluted at the end of the legislative process so that, in cases of unemployment directly prior to retirement, the last two years spent in receipt of unemployment benefits will, as a general rule, not count towards the 45 years of contributions required to receive a full pension without actuarial

14 The financial development of the statutory health and public long-term care insurance schemes in the first quarter of 2014 was discussed in the short articles of the Bundesbank's July Monthly Report. These are the most recent data available.

deductions.[15] It will thus become more difficult to use receipt of unemployment benefit as a way of leaving employment that is subject to social security contributions early, as was commonly done in the past. Additionally, agreements relating to the termination of a person's employment contract upon reaching statutory retirement age can be deferred indefinitely by mutual agreement of the employer and employee. Furthermore, there are also plans for a parliamentary commission to develop proposals on how to make retirement options more flexible in general. Pension legislation states that certain groups of insured persons may retire before reaching statutory retirement age – with actuarial deductions of 3.6%.[16] In accordance with pension legislation, it is also generally possible to remain in the workforce indefinitely and earn a 6% increment for each year of additional work. However, increasing the flexibility of pension insurance policies will, in principle, be accompanied by higher costs overall if actuarial deductions and increments are calculated based on the average life expectancy of insurees.[17]

Finances of the Federal Employment Agency

€ billion, quarterly data



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

Federal Employment Agency

Improvement in 2014 Q2

The Federal Employment Agency recorded a surplus of almost €½ billion in the second quarter of 2014, following a slight deficit in the same period last year. While revenue grew by almost 4%, expenditure fell by 2½%. Contribution inflows saw continued growth of 4%, which reflects ongoing favourable employment and wage developments. On the expenditure side, spending on unemployment insurance

15 By comparison, periods of unemployment are counted in full during this time if they are due to the employer filing for bankruptcy or to business closure. Furthermore, in the two years prior to retirement, it is possible to take up employment that is subject to social security contributions but, as a general rule, does not entail more than 15 working hours per week, thereby allowing the employee to receive unemployment insurance benefit (I) at the same time (taking into account any net income over €165 per month). Such periods of employment also count towards years of contributions to the statutory pension insurance scheme (section 138(3) of Social Security Code III).
16 Long-term insurees with 35 years of insurance (including periods of unemployment) can draw a statutory pension with actuarial deductions from the age of 63. The statutory retirement age is 65 for severely disabled persons, while early retirement with actuarial deductions can be taken from the age of 62.
17 If, for example, above all persons with a below-average life expectancy opt for early retirement, it is not sufficient to calculate their actuarial deductions based on the average life expectancy of all insured persons, because the additional pension expenditure due to taking early retirement is set against lower accumulated pension cuts on balance. Furthermore, if above all persons with an above-average life expectancy postpone retirement, their increment is set at an excessively high level. The reduced period during which they are in receipt of a pension will then be more than offset by the total number of higher current pensions. These scenarios assume quite plausibly that people tend to assess their health risks appropriately as compared against the average of their cohort, and can thus make decisions which benefit them.

benefit (I) fell by just over 1½%. Payments for short-time working benefits even halved on the year. By contrast, spending on active labour market policy measures rose by almost 6½%.

Appreciable surplus expected for year as a whole

The Federal Employment Agency is expected to record a surplus if favourable conditions on the labour market continue; this is likely to be markedly higher than envisaged in the Agency's budget plan (target: €¼ billion). However, payments for unemployment insurance benefit (I) recently increased slightly. In its capacity as an automatic stabiliser, the Federal Employment Agency responds in an especially sensitive manner to overall economic fluctuations, particularly on the expenditure side. In structural terms, the financial risks arising from the latest pension reform have recently been reduced by limiting the extent to which periods in receipt of unemployment insurance benefit (I) directly before retirement can be counted towards contribution years. As such, it is less likely that this wage substitute will be used as a bridge to early retirement.