

## Public finances\*

### General government budget

*Public finances played major stabilising role in 2020*

German fiscal policy was strongly geared towards tackling the coronavirus crisis in the past year. Starting from the first wave of infections in March, policymakers took extensive measures to support the healthcare system, enterprises and households. General government investment also continued to grow at a dynamic pace – relative to trend economic output, it thus returned to a level last seen in the mid-1990s. Furthermore, the automatic stabilisers took effect, with tax and social contribution shortfalls as a result of the economic downturn and lost wage income being offset to some extent by social benefits.

*High deficit*

As a result, a considerable general government deficit was recorded. The Federal Statistical Office's first calculations published in January put it at 4.8% of gross domestic product (GDP). The balance had still been positive in 2019, with a surplus of 1.5% of GDP being posted (for more details on developments, see pp. 70ff.). The deterioration was more or less in line with the surge in the expenditure ratio (see the adjacent chart). This surge was due in large part to the economic downturn: nominal GDP in the denominator decreased, whereas wage replacement benefits increased. By contrast, as is usual, the revenue ratio changed less due to cyclical conditions, as revenue (numerator) and nominal GDP (denominator) declined to a similar extent.<sup>1</sup>

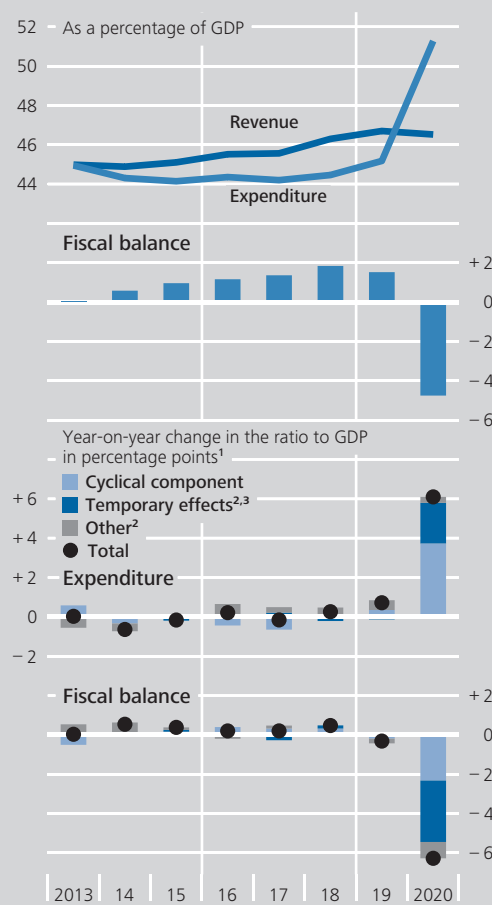
\* The section entitled "General government budget" relates to data from the national accounts and the Maastricht debt ratio. This is followed by more detailed reporting on budgetary developments (government finance statistics). No data for the fourth quarter of 2020 are yet available for local government or the statutory health and public long-term care insurance schemes. These will be analysed in the short commentaries in upcoming issues of the Monthly Report.

<sup>1</sup> Looking at cyclical factors alone, the revenue ratio actually increased, as taxes and social contributions were less adversely affected by the crisis than nominal GDP. This very largely offset the decrease caused by fiscal policy measures, especially tax relief measures intended to support the economy.

By the end of the third quarter of 2020, the debt ratio had risen to 70.0% (end-2019: 59.6%). The decreased nominal GDP in the ratio's denominator accounted for 2 percentage points of this increase. A far more significant contributing factor was debt growth. First, it reflected budget deficits. Second, government budgets included borrowing to top up deposits in net terms – especially at the central government level. One particular reason for this was presumably to put funds aside as a precautionary measure during uncertain crisis

*Strong debt growth*

### General government fiscal ratios and main components affecting developments\*



\* General government budget as defined in the national accounts. <sup>1</sup> For information on the breakdown, see pp. 70 ff. <sup>2</sup> Change in the ratio to trend GDP. <sup>3</sup> In 2020, these largely concern the fiscal policy measures implemented in response to the coronavirus crisis.

## Public finances in 2020: automatic stabilisers and temporary measures strongly supported the economy\*

In 2020, developments in Germany's public finances were shaped by the coronavirus crisis. As a result, the surplus of 1.5% of gross domestic product (GDP) recorded in 2019 was followed by a large deficit. According to the preliminary data from January, this deficit amounted to 4.8% of GDP. This box outlines the impact of cyclical, special temporary and other (structural) effects on this development. It is important to note that the data are currently subject to greater uncertainty than usual.<sup>1</sup> It is likely that subsequent revisions to the figures given here will thus be more significant as a result.

### Economic downturn had significant impact

While the cyclical impact on the government budget was still positive in 2019, the coronavirus pandemic caused it to turn significantly negative in 2020. The economic downturn led

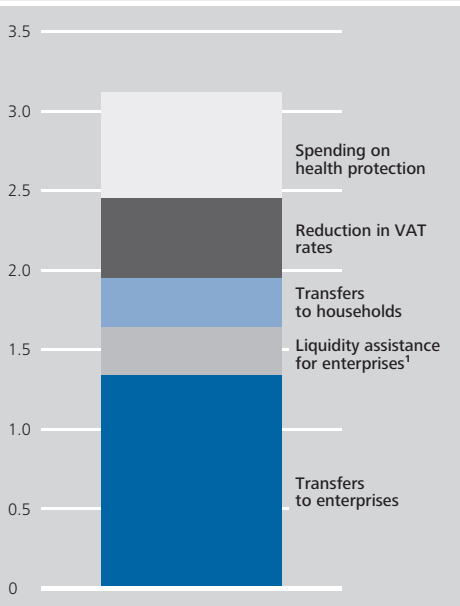
to a fall in taxes and placed a dampener on social contributions. At the same time, expenditure on short-time working and unemployment benefit rose substantially. These factors acted as automatic stabilisers to counter the economic downturn, i.e. they took effect without any additional government measures. Calculations using the Bundesbank's methodology show that unfavourable cyclical influences caused the general government fiscal balance to deteriorate by 2¼% of GDP in 2020 (see also the table on p. 71, row "Cyclical component").

### Temporary burdens due to extensive support measures

Fiscal policy measures to tackle the coronavirus crisis had an even greater impact than cyclical developments. These pandemic response measures were designed to be temporary, meaning that their negative influence on the government budget is also temporary. Their aim is to support the healthcare system, enterprises and households and to stabilise the economy.<sup>2</sup> These measures combined increased the government deficit in 2020 by an estimated 3% of GDP (see the adjacent chart and the table on p. 71, row "Special temporary effects").

### Temporary coronavirus response measures in 2020\*

As a percentage of GDP



\* Bundesbank estimates. Transfers to enterprises and households comprise all measures that provide comprehensive relief and do not entail any repayment obligation. <sup>1</sup> Special tax rules that shift enterprises' tax payments along the time axis.  
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\* The calculations are based on the January national accounts figures and also include assumptions about future developments. See Deutsche Bundesbank (2006) for methodological notes on the analytical approach used here.

<sup>1</sup> For example, cash inflows from tax revenue in 2020, data for which are now available, exceed the official tax estimate made in November 2020. These usually feed into the preliminary national accounts figures. In addition, the effects of the coronavirus crisis on medium-term economic developments, and thus also the current deviations from the trend level, are difficult to gauge. Furthermore, not all pandemic-related temporary effects on the government budget can be separated from structural developments. These include lower expenditure on medical treatments unrelated to COVID-19 and a loss of revenue from fees due to temporary closures of public institutions.

<sup>2</sup> See Deutsche Bundesbank (2020a), pp. 21-23 for more details on the fiscal policy coronavirus response measures.

## Structural development of the government budget\*

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

Item	2013	2014	2015	2016	2017	2018	2019	2020	2019 in rela- tion to 2012
Unadjusted fiscal balance <sup>1</sup>	0.0	0.5	0.4	0.2	0.2	0.5	-0.3	-6.3	1.5
Cyclical component <sup>1</sup>	-0.5	0.1	0.2	0.4	0.3	0.3	-0.2	-2.3	0.6
Special temporary effects <sup>1</sup>	0.1	-0.1	0.1	0.0	-0.3	0.2	0.1	-3.1	0.1
Fiscal balance	0.4	0.6	0.1	-0.2	0.2	0.0	-0.2	-0.8	0.8
Interest payable	-0.5	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-1.5
Primary balance	-0.1	0.4	-0.1	-0.4	0.0	-0.1	-0.4	-1.0	-0.7
Revenue	0.0	0.2	0.2	0.4	0.4	0.5	0.3	-0.5	1.9
Taxes and social contributions	0.1	0.0	0.3	0.4	0.5	0.3	0.3	-0.2	2.0
Fiscal drag <sup>2</sup>	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.7
Decoupling of macroeconomic reference variables from GDP	0.0	0.0	0.0	0.1	0.2	0.1	0.0	0.0	0.4
Legislative changes	-0.2	0.0	0.0	0.0	-0.1	-0.1	-0.2	-0.2	-0.6
Residual	0.2	-0.1	0.2	0.2	0.4	0.3	0.3	-0.1	1.5
Other revenue <sup>3</sup>	-0.1	0.2	-0.2	-0.1	-0.1	0.1	0.0	-0.3	-0.1
Primary expenditure	0.1	-0.2	0.2	0.8	0.4	0.6	0.6	0.4	2.5
Social payments	-0.2	0.1	0.3	0.5	0.4	0.1	0.3	0.0	1.4
Subsidies	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.1	0.0
Compensation of employees	0.0	0.0	-0.1	0.0	0.1	0.1	0.1	0.1	0.2
Intermediate consumption	0.1	0.0	0.0	0.2	0.1	0.0	0.1	0.0	0.4
Gross fixed capital formation	-0.1	-0.1	0.0	0.1	-0.1	0.1	0.1	0.1	0.3
Other expenditure <sup>4</sup>	0.3	-0.2	-0.1	0.1	-0.1	0.2	0.1	0.1	0.3

\* The structural figures are derived by adjusting for cyclical influences and special temporary effects. **1** Change in the ratio to GDP. **2** The term "fiscal drag" encompasses the positive revenue effect of bracket creep in income taxation and the negative impact of the fact that specific excise duties are largely independent of prices. **3** Other current transfers receivable, sales and total capital revenue. **4** Other current transfers payable, other net acquisitions of non-financial assets and capital transfers payable.

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Support measures for enterprises were the largest item in terms of quantity. Of these measures, by far the largest share was accounted for by the immediate assistance for small businesses, the self-employed and freelancers. In addition, the Federal Employment Agency paid enterprises' social contributions for recipients of short-time working benefits.<sup>3</sup> Various special tax arrangements boosted enterprises' liquidity. Households were supported primarily via a bonus child benefit payment. In addition, VAT rates were lowered in the second half of 2020. Health protection measures comprised additional expenditure on personal protective equipment, intensive care beds, promoting the development of vaccines and providing information to the general public. Furthermore, central government made compensation payments to hospitals for keeping beds unoccupied. Other parts of the healthcare sector received compensation for the reduced demand for certain services caused by the pandemic and their resulting losses of income.

### Moderate deterioration in the structural balance

Adjusting for the cyclical and temporary coronavirus response measures outlined above reveals the structural deterioration in the government budget,<sup>4</sup> which is less strong. The structural fiscal balance declined by ¾% of GDP (see the table above, row "Fiscal balance"). The government budget thus stabilised the economy primarily via the temporary coronavirus response measures and the effect of the automatic stabilisers.

The structural deterioration in the fiscal balance was due in roughly equal measure to a falling revenue ratio and a rising expenditure

<sup>3</sup> Expenditure on short-time working benefits accruing to employees is largely included in the category of cyclical influences (similarly to employment benefit!).

<sup>4</sup> When comparing the calculations of the Federal Government with those of the European Commission, it is important to note that the Commission's figure for the structural fiscal balance does not factor out the temporary coronavirus response measures.

ratio. On the revenue side, there was, for example, a decline in receipts from fees. This reflected the fact that many public institutions were subject to temporary closures as a result of contact restrictions. In addition, there were cuts to income taxes (particularly via the Family Relief Act (*Familienentlastungsgesetz*)), to the contribution rate to the unemployment insurance scheme and to health insurance contributions on occupational pensions. On the expenditure side, although interest expenses continued to fall, personnel expenditure and fixed asset formation experienced dynamic growth. Moreover, substantial additional funds were transferred to the EU budget at the end of the seven-year planning period. It is important to note that medical services that were not used or were merely postponed had a temporary easing effect on the structural balance. This special effect is likely to have been larger than the aforementioned special effect relating to receipts from fees.

### Government budget broadly back in balance in structural terms

The current assessment is that, in structural terms, the government budget closed 2020 broadly in balance. The actual deficit is thus essentially explained by the unfavourable economic conditions and the temporary coronavirus response measures. This brought the phase of structural surpluses that began in 2013 to an end. During this period, the sharply rising structural social contributions ratio and falling interest expenditure had a very significant easing effect on public finances. Meanwhile, however, there was high expenditure growth in other areas – primarily in pensions, healthcare and long-term care. Government investment spending also increased considerably; having experienced dynamic growth in recent years, the latest figures put it at 2½% in relation to trend GDP, its highest point since the mid-1990s.

conditions. Third, debt growth of just under 1% of GDP was generated by crisis support, which was accompanied by financial asset acquisitions (and thus recorded as having no impact on the deficit). This debt comprises government-guaranteed assistance loans, which are refinanced in large part by the Economic Stabilisation Fund, and government stakes in individual firms. The debt ratio may have stood at around 70% at the end of 2020, too. Some deposits that had previously been topped up appear to have been used in the fourth quarter to cover deficits and bring debt back down somewhat.

Given that it is very difficult to predict the future course of the pandemic, the outlook for government finances this year remains extremely uncertain. As things stand, the deficit is likely to be roughly on a par with the one seen in 2020. Some parts of the economy will initially continue to feel the debilitating force of the restrictions in place. Accordingly, numerous

support measures that are of a fundamentally temporary nature will either remain in force or be adapted and prolonged. In addition, measures implemented in 2020 will have a delayed impact in some cases. All in all, however, the temporary strains stemming from economic developments and time-limited support measures will diminish somewhat. However, there are new structural budgetary burdens working in the other direction, stemming notably from the partial abolition of the solidarity surcharge and a significant raising of child benefits. The debt ratio could remain around the 70% mark this year: while new borrowing will inflate the ratio, a return to nominal GDP growth in the denominator will push it down.

A significant drop in the deficit and debt ratios is therefore on the horizon over the coming years. This is because, as things stand, the economy will recover further and many support measures will no longer be in place. Nevertheless, a structural deficit can be ex-

*2021: deficit and debt ratio expected to be on similar scale as in 2020*

*Public finances will recover as crisis subsides, but structural deficit still foreseeable*

pected in the medium term in the absence of any further adjustments. For 2022, for example, many of the projections published since the fourth quarter of 2020 indicate a structural deficit of around 2% of GDP. In light of the economic recovery and the foreseeable increase in contribution rates, taxes and contributions are expected to rise significantly. The structural tax and social contributions ratio could thus potentially come close to the record high reached in 2000. However, spending is also likely to experience dynamic growth. Additional funds have been – and are continuing to be, irrespective of the COVID-19 crisis – earmarked for areas including education, climate policy and digitalisation. Moreover, expenditure on pensions, healthcare and long-term care is growing rapidly in the wake of political decisions and as a result of demographic change. The structural primary expenditure ratio (total expenditure excluding interest) could thus hit a new record high in the next few years.<sup>2</sup> By contrast, interest expenditure is likely to remain exceptionally low, despite the higher debt level. This is due to the very favourable financing conditions that have been maintained for several years now.

*Focus still on crisis management while keeping an eye on medium-term challenges*

Overall, it is appropriate for fiscal policy to remain focused on stabilisation at first in order to deal with the crisis as effectively as possible. That said, crisis support should remain temporary in nature. In general, it is important to keep an eye on medium-term fiscal challenges when considering permanent additional expenditure or revenue decreases. A good way to anchor a multitiered policy of this sort consists of fiscal rules that provide fiscal leeway in a crisis while at the same time ensuring a solid outlook for public finances. In principle, this could take various forms. This two-pronged objective has been catered for in both the European fiscal rules and the German debt brake.

The extent to which the fiscal rules will necessitate fiscal consolidation after the coronavirus crisis is currently difficult to gauge. However, the latest projections indicate that the addi-

tional need for action by the government as a whole as a result of the crisis does not appear exceptionally great. Moreover, the rules allow the necessary overall consolidation to be spread out over a period of years. Under EU rules, a country's non-compliance with its medium-term objective may be corrected gradually rather than all at once. Under the national debt brake, consolidation can be spread out over time by making use of the large reserves. At present, however, the first item on the agenda is to tackle the pandemic. In any case, the central government budget for 2022 will not be adopted until after the German general election. At that point, it should be possible to better assess the success of the vaccination programme, in particular, and to more reliably evaluate the general economic recovery process.

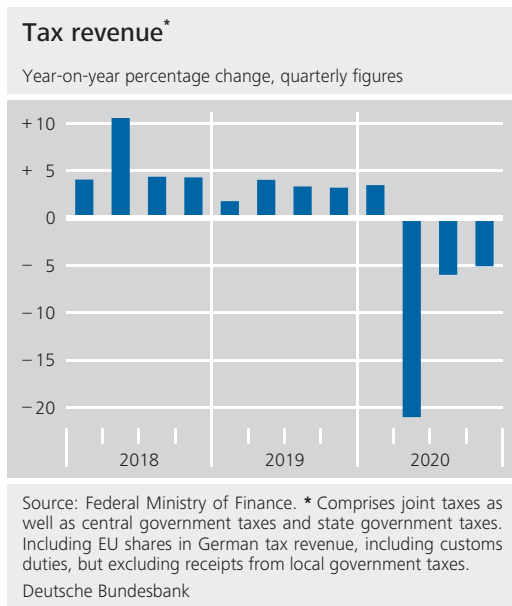
Regardless of the COVID-19 crisis, the social security funds will require considerable structural adjustment in the future. This is mainly the result of demographic change, but also of the extensive benefit increases adopted over the last few years. Contribution rates are therefore expected to rise sharply – first for the health insurance scheme and then for the pension and long-term care insurance schemes. It will be key here to set out a roadmap for social contribution rates, government funds and the level of benefits going forward. Without further adjustment, the central government budget is unlikely to have the capacity to take on additional structural burdens here.

*As things stand today, post-crisis need for consolidation not excessive and to span multiple years*

*Social security funds under financing pressure*

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<sup>2</sup> In the period from 1991 to 2020, the structural tax and social contributions ratio reached its peak of 42% in 2000, while the structural primary expenditure ratio hit a high of 46½% in 1991. In 2020, these figures stood at 41% and 45½%, respectively. In the case of structural ratios, specific temporary effects (such as one-off expenditure in response to the coronavirus pandemic) and cyclical effects are disregarded (estimated using the Bundesbank framework; see pp. 70 ff.).



## Budgetary development of central, state and local government

### Tax revenue

Tax revenue<sup>3</sup> went down by 7½% in 2020 (see the above chart and the table on p. 75). Besides the economic downturn stemming from the coronavirus pandemic, this was also the result of tax cuts, most of which were measures to mitigate the fallout from the crisis. To wit, VAT was temporarily cut in the second half of the year and a bonus child benefit payment was made. However, revenue was considerably higher than projected in the official tax estimate of November 2020 (+€9 billion). The rate of change was thus 1½ percentage points more favourable than in the official estimate. The positive deviations are spread across the major individual taxes and, as a positive base effect, are likely to raise expectations to a large extent for the current year.

*Tax revenue down significantly in 2020*

*Measures taken to combat COVID-19 crisis cause VAT, wage tax and profit-related taxes to drop sharply*

Just under half of the tax revenue shortfall was attributable to VAT (-10%). One of the main reasons for this was that private consumption has declined significantly during the pandemic. Unlike in the 2008-09 financial and economic crisis, it has not had a stabilising effect on rev-

enue. The VAT cuts were another key factor in this. However, their impact had not yet been fully felt, as VAT is paid with a lag of up to two months. Wage tax fell by 4½%. Lost wages due to short-time working were a major contributing factor here.<sup>4</sup> Added to this was a bonus child benefit payment together with the fact that child benefits were raised in mid-2019: both are deducted from wage tax revenue. The raising of tax allowances and shifting to the right of the income tax scale<sup>5</sup> at the start of 2020 likewise had a dampening effect on revenue. All in all, profit-related taxes fell considerably owing to the decline in economic activity, with corporation tax being most affected (-24%).

The tax estimate of November 2020 forecast revenue growth of 6½% (including local government taxes) for the current year. Slower growth is then expected in the years thereafter. On the one hand, the more favourable 2020 outturn than the one projected in the November estimate is likely to raise revenue expectations markedly. On the other hand, the slightly more unfavourable economic prospects in the Federal Government's latest macroeconomic projection from the start of the year will lower them somewhat.

*Starting in 2021, tax revenue still under pressure from coronavirus crisis and ...*

Tax cuts that have been implemented in the meantime will also have an impact: in particular, the November estimate did not take account of the fact that tax allowances and the income tax scale have been adjusted for 2021 and 2022 and that child benefits were raised significantly at the start of the year. In order to improve their liquidity position, enterprises can – in much the same way as last year – have special advance VAT payments deferred for one

*... fresh tax cuts*

<sup>3</sup> Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the year.

<sup>4</sup> Short-time working reduces wages, and short-time working benefits themselves are not taxed. However, they are factored in when determining an individual's tax rate (*Progressionsvorbehalt*), which will probably bolster assessed income tax somewhat, especially this year.

<sup>5</sup> When the scale is shifted to the right, the rising tax rates that it contains then apply as of higher income brackets.

Tax revenue									
Type of tax	Year as a whole				Estimate for 2020 <sup>1</sup>	Q4			
	2019	2020	Year-on-year change			2019	2020	Year-on-year change	
	€ billion	€ billion	€ billion	%	%	€ billion	€ billion	€ billion	%
Tax revenue, total <sup>2</sup>	735.9	682.3	- 53.5	- 7.3	- 8.5	196.3	186.3	- 10.0	- 5.1
of which:									
Wage tax	219.7	209.3	- 10.4	- 4.7	- 5.1	60.6	57.7	- 3.0	- 4.9
Profit-related taxes	124.4	111.5	- 12.8	- 10.3	- 15.1	29.0	31.4	+ 2.4	+ 8.4
Assessed income tax <sup>3</sup>	63.7	59.0	- 4.7	- 7.4	- 8.9	16.6	16.1	- 0.4	- 2.6
Corporation tax	32.0	24.3	- 7.7	- 24.2	- 34.1	7.1	8.0	+ 0.9	+ 12.4
Non-assessed taxes on earnings	23.5	21.5	- 2.0	- 8.5	- 15.1	4.0	5.6	+ 1.6	+ 40.6
Withholding tax on interest income and capital gains	5.1	6.8	+ 1.6	+ 31.4	+ 25.3	1.3	1.6	+ 0.4	+ 27.9
VAT <sup>4</sup>	243.3	219.5	- 23.8	- 9.8	- 10.1	62.7	55.3	- 7.4	- 11.7
Other consumption-related taxes <sup>5</sup>	93.0	90.1	- 2.9	- 3.1	- 3.8	27.9	27.3	- 0.6	- 2.2

Sources: Federal Ministry of Finance, Working Party on Tax Revenue Estimates and Bundesbank calculations. <sup>1</sup> According to official tax estimate of November 2020. <sup>2</sup> Comprises joint taxes as well as central government taxes and state government taxes. Including EU shares in German tax revenue, including customs duties, but excluding receipts from local government taxes. <sup>3</sup> Employee refunds deducted from revenue. <sup>4</sup> VAT and import VAT. <sup>5</sup> Taxes on energy, tobacco, insurance, motor vehicles, electricity, alcohol, air traffic, coffee, sparkling wine, intermediate products, alcopops, betting and lottery, beer and fire protection.

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year on request. Taken by themselves, these and other measures will reduce the tax revenue generated in 2021 by 2% compared with the last official estimate. Next year, shortfalls will be smaller, at 1%, as this year's special advance VAT payments will probably have been made at that point (without these being offset by subsequent deferrals). In the medium term, tax revenue will then be 1½% lower due to the tax cuts made since the tax estimate was prepared. Further legislative changes are in the pipeline: for instance, the governing coalition agreed in early February to extend the VAT rate cut on restaurant meals until the end of 2022. A bonus child benefit payment of €150 per child will be made this year. By contrast, tax loss carrybacks were only increased rather than being expanded to cover years before 2019 or to include local business tax. Hopes for a more significant expansion of this targeted rapid assistance for crisis-hit businesses were thus not fulfilled. The package will result in tax revenue shortfalls of around €4½ billion (½% of tax revenue)

enue) this year and €3 billion next year. In addition, giving firms the ability to write off IT equipment more quickly is currently being discussed.

Overall, tax revenue will thus fall significantly short of pre-crisis expectations in the medium term, too.<sup>6</sup>

*Taxes short of pre-crisis expectations in medium term*

## Central government budget

According to preliminary figures, central government posted a very large deficit of €131 billion at the end of the pandemic year of 2020 (2019: surplus of €13 billion). Additional spending directed, inter alia, at central government off-budget entities, the Federal Employment Agency and local government, placed a heavy

*Very large deficit in 2020 due to COVID-19 pandemic*

<sup>6</sup> For more details on the official tax estimate, see Deutsche Bundesbank (2020b), pp. 63 ff.

strain on the budget in the final quarter of the year, in particular.

*Year-on-year comparison: revenue down sharply and expenditure soaring*

Revenue fell by 11% (-€41 billion) last year, due primarily to lower tax revenue. Expenditure rose by 28% (+€103 billion). Payments to central government off-budget entities grew by a particularly large amount (+€31 billion). Much of this sum was used to finance the Energy and Climate Fund in advance. Payments to state governments rose by €23 billion. These were used to provide extensive support to local governments and hospitals, in particular. The social security funds received a €9 billion increase in transfers, of which just over half was special funds for the health fund and the long-term care insurance scheme. Furthermore, the Federal Employment Agency was granted a loan to balance its budget (€7 billion). Transfers to enterprises went up by €20 billion and largely took the form of emergency and bridging aid.<sup>7</sup> Investment grants and other operating expenditure (such as purchases of personal protective equipment) likewise went up sharply. By contrast, interest expenditure fell substantially due to the large-scale issuance of Federal securities seeing even higher premiums being collected overall.

*Compared to second supplementary budget, budget balance far better*

While there was a very sharp year-on-year deterioration in the budget balance, it was still €87 billion better than projected in the second supplementary budget passed in the summer of 2020. Less unfavourable economic conditions contributed to a €19 billion improvement in tax revenue. Spending was €67 billion below authorised expenditure limits, with €25 billion less than allotted being spent on business aid alone. Including advance payments for November and December aid, only €4 billion (just under one-sixth of allotted funds) was spent on the sub-item bridging aid. The application deadline had not yet passed at the end of the period under review, and barely one-third of the aid applied for had been paid out. Investment expenditure (according to the broad budgetary definition) was €21 billion lower than budgeted. However, this did not have a

strong impact on fixed asset formation. Instead, almost no claims from guarantees had to be paid out, though these had been put at €7 billion. The €6 billion recapitalisation of Deutsche Bahn was postponed to this year. Finally, the loan to the Federal Employment Agency and the investment grants were significantly smaller than envisaged. In the case of the basic allowance for job seekers, payments were €9 billion lower than budgeted. It would appear that the rate of additional take-up following the relaxation of eligibility criteria was heavily overestimated. The Federal Ministry of Health spent €3 billion less than was allotted for personal protective equipment and medication. Lower interest expenditure brought €3 billion in relief due to premiums being higher than expected.

The high level of borrowing was made possible by activating the debt brake's escape clause. It had been envisaged that the standard limit would be exceeded by €119 billion. At €39 billion, the amount by which the limit was overshoot was ultimately far lower.<sup>8</sup> As a result, the annual repayments to be made between 2023 and 2042 are only €2 billion rather than the expected €6 billion. The main reason for the more favourable outcome was that the amount borrowed was €87 billion less than envisaged. In addition, the surpluses generated by the off-budget entities that are included in the debt brake were €9 billion higher. The fact that smaller than envisaged amounts of net funds borrowed were attributable to the cyclical burden and financial transactions had a negative impact (+€8 billion in each case), however. The former was due to better than expected economic developments, while the latter related to the postponement of Deutsche Bahn's recapitalisation and the smaller loan to the Federal Employment Agency.

*Repayment obligation in connection with debt brake: €2 billion per year from 2023 to 2042 and far lower than expected*

<sup>7</sup> The funds were ultimately directed to enterprises via state governments. That is why this aid was initially recorded in state government budgets as revenue from central government.

<sup>8</sup> The final figure will be determined in early September on the basis of the revised national accounts data. Significant changes are not expected.

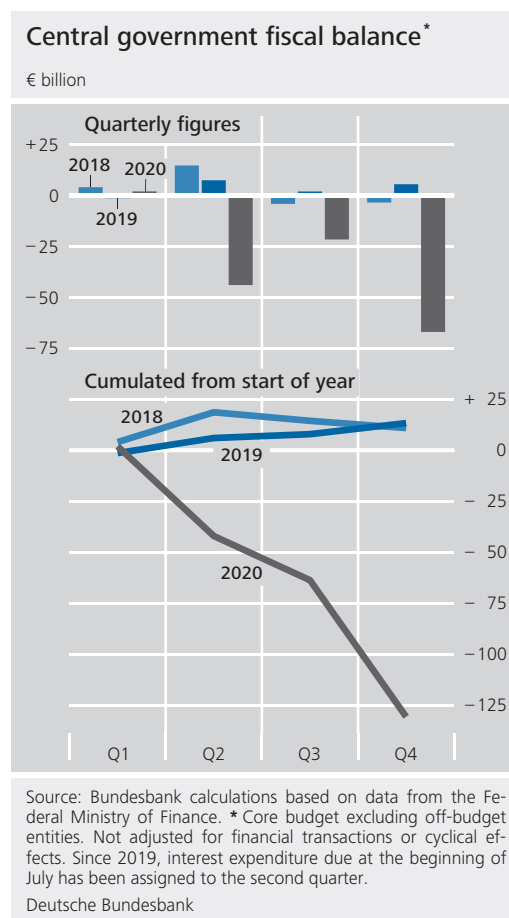


*Very large deficit planned for 2021, too, but more favourable result possible, not least due to factored-in buffers*

Central government envisages net borrowing of just under €180 billion for the current year. In view of the further intensification of efforts to combat the pandemic, the September draft expenditure framework was expanded significantly in the final deliberations at the end of November. In particular, funds for business aid (+€38 billion), general provisioning (+€30 billion) and healthcare expenditure (+€11 billion for vaccines, personal protective equipment and unoccupied hospital beds, for example) were topped up. Furthermore, the postponed recapitalisation of Deutsche Bahn was factored into the budget planning (+€6 billion). The credit limit imposed under the debt brake is now set to be exceeded by €164 billion. The necessary repayments envisaged from 2026 to 2042 amount to €10 billion each year. As things currently stand, however, the budget should close the year with a much better result. Some of the relief afforded by 2020's more favourable budget outturn, for instance, is continuing to take effect, and very large amounts have been earmarked for general provisioning and business aid. The decisions taken by the coalition committee on 3 February will use only a small portion of these funds: the child bonus and one-time payments for recipients of the basic allowance, each totalling €150, increased tax loss carryback options, the extension of the VAT rate cut for restaurants and of the expanded entitlement to basic allowance benefits as well as additional aid for those in cultural professions could cost central government around €3 billion in total. Other announced additional spending, for instance on vaccines and the public long-term care insurance scheme in the order of €10 billion does not change the overall picture, either.

*Benchmark figures for subsequent years should identify need for action to comply with debt brake from today's perspective*

In its fiscal plan of autumn 2020, the German Federal Government expressed its intention to return to the normal fiscal rules as of 2022. In March, it will adopt the benchmark figures for the 2022 budget and for the fiscal plan up to 2025. Here it is important to transparently present any additional budgetary burdens that are planned. Additionally, it should be clearly



shown how the reserves have been planned into the budget and what degree of financial consolidation is required in the medium term from today's perspective.

In March too, however, budgetary prospects are still likely to be very uncertain. The need for action may therefore change significantly in either direction. Furthermore, the focus is currently on the ongoing need for fiscal support in response to the pandemic. Under these circumstances, the government does not yet have to make concrete consolidation decisions for the benchmark figures. However, it is important that the estimated need for action does not get overlooked – for example, in election campaigns and government programmes. According to current expectations, the pandemic will subside in Germany during the course of this year. The most recent Federal Government financial plan therefore does not include any further activation of the debt brake escape clause as of 2022. Pursuant to the plan, the budget

*Consolidation measures not yet necessary*

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

€ billion

Item	2019	2020		2021
	Actual	Second supplementary budget	Actual	Budget
1. Expenditure <sup>1</sup>	343.2	508.5	441.8	498.6
of which:				
Investment	38.1	71.3	50.3	61.9
Global spending increases/cuts	–	– 2.3	–	26.3
2. Revenue <sup>1,2</sup>	356.5	290.4	311.1	318.6
of which:				
Tax revenue <sup>1</sup>	329.0	264.4	283.3	292.8
Global revenue increases/shortfalls	–	–	–	– 3.0
3. Fiscal balance (2.–1.)	13.3	–218.1	–130.7	–180.1
4. Coin seigniorage	0.2	0.3	0.2	0.2
5. Transfer to (–)/withdrawal from (+) reserves	–13.5	–	–	–
6. Net borrowing (–)/repayment (+) (3.–4.+5.)	–	–217.8	–130.5	–179.8
7. Cyclical component in the budget procedure	–2.7	–53.6	–45.3	–12.8
8. Balance of financial transactions	0.0	–14.6	–6.6	–8.5
9. Balance of relevant off-budget entities	0.7	19.1	27.7	–17.8
Energy and Climate Fund	1.8	20.4	25.3	–13.8
Flood Assistance Fund	–0.6	–0.7	–0.4	–0.3
Fund to Promote Municipal Investment	–0.9	–1.3	–1.0	–1.4
Digitalisation Fund	0.3	–1.0	1.3	–1.8
Fund for Primary School-Age Childcare Provision		1.8	2.5	–0.4
10. Structural net borrowing (–)/repayment (+) (6.–7.–8.+9.)	3.3	–130.4	–50.9	–176.3
11. Amount exceeding ceiling (12.–10.)		118.7	39.1	164.2
12. Regular ceiling: structural net borrowing (0.35% of GDP) <sup>3</sup>	–11.5	–11.7	–11.7	–12.1
13. Structural fiscal balance (3.–7.–8.+9.)	16.7	–130.8	–51.1	–176.5
as above, with estimate of potential output according to Annual Economic Report for 2021	1.7	–154.9	–66.9	–172.5
14. Balance of the general reserve	48.2	48.2	48.2	48.2
15. Balance of the control account	52.0	52.0	52.0	52.0

Sources: Federal Ministry of Finance and Bundesbank calculations. \* For methodological notes, see Deutsche Bundesbank (2016). <sup>1</sup> After deduction of supplementary central government grants, shares of energy tax revenue, compensation under the 2009 reform of motor vehicle tax and consolidation/budgetary recovery assistance to federal states, excluding transfers to/withdrawals from reserves. <sup>2</sup> Excluding coin seigniorage. <sup>3</sup> Based on gross domestic product in the year before the comprehensive budget is prepared.

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gap would have to be closed in the draft budget for 2022 by the next Federal Government. The extensive reserves could then be used to smooth the adjustment in harmony with economic developments.

Central government's off-budget entities concluded 2020 with a deficit of €6 billion (excluding the Financial Market Stabilisation Fund (SoFFin), bad banks and other entities that use commercial double-entry bookkeeping),<sup>9</sup> having posted a surplus of €5 billion the previous year. Outflows of €40 billion from the Economic Stabilisation Fund, largely for refinancing coronavirus assistance loans offered by the

KfW banking group, were the decisive factor in this deficit. The Economic Stabilisation Fund's total authorised borrowing limit of €200 billion therefore still affords considerable scope for further aid. The Energy and Climate Fund recorded a high surplus of €25 billion (budgeted figure: €20 billion); it received extensive finan-

<sup>9</sup> According to figures from the Federal Ministry of Finance. The Federal Ministry of Finance does not publish quarterly data for off-budget entities that keep commercial accounts, such as the bad bank FMS Wertmanagement. The deficit generated by SoFFin, which uses a single-entry accounting system, has also been excluded here. SoFFin has been taking out loans since 2019 and lending these funds to FMS Wertmanagement, which uses them to refinance legacy debt. Overall, therefore, SoFFin's deficit does not increase central government's consolidated debt level.

Central government's off-budget entities recorded clear deficit in 2020 owing to Economic Stabilisation Fund

cing for future expenditure from the central government budget upfront and paid out only three-fifths of the planned expenditure amount. The prefinancing of future spending also resulted in a total surplus of €4 billion for the Digitalisation Fund and the All-day Schools Fund. While prefinancing off-budget entities with new central government loans is inconsistent with the principle of annuality, it does not circumvent debt brake rules, as these special funds are included in the debt brake.

*Increased deficit foreseeable for 2021 chiefly due to stabilisation of renewable energy (EEG) levy*

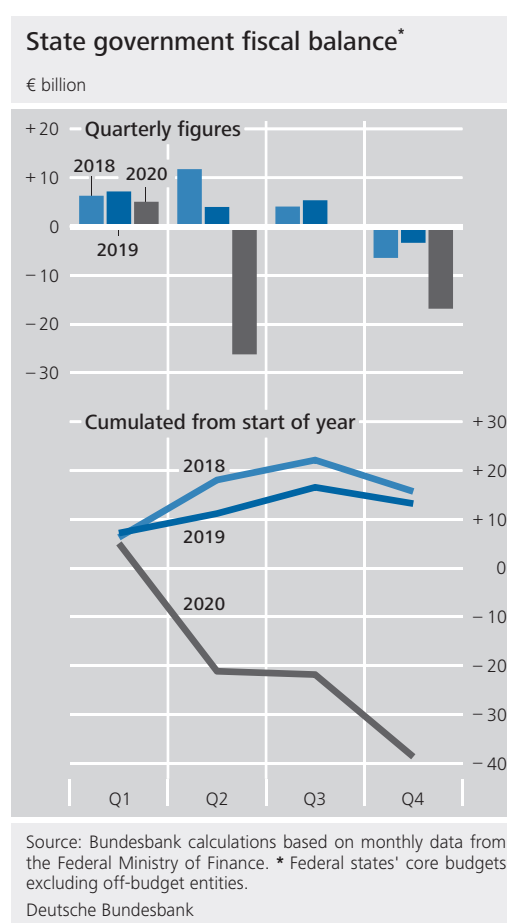
A high deficit of €14 billion is forecast for the Energy and Climate Fund in the current year. In addition to climate measures, an €11 billion grant to stabilise the renewable energy (EEG) levy imposed on electricity prices will be paid. Further aid is likely to be taken up from the Economic Stabilisation Fund on account of the ongoing coronavirus pandemic. Return flows from, for instance, repayments of assistance loans will also probably remain limited, making a further deficit plausible. Overall, together with the planned outflows from the funds, the deficit for off-budget entities recorded last year would then be significantly exceeded. However, it remains to be seen whether there will be substantial delays once again in implementing the planned projects.

## State government budgets<sup>10</sup>

*Core budgets ended 2020 with very high deficit*

The federal states' core budgets finished 2020 with a very high deficit of €39 billion. In the previous year, they had posted a surplus of €13 billion. Missing data on the federal states' off-budget entities need to be incorporated in order to draw a comprehensive picture. Extensive pandemic-related payments between the core budgets and off-budget entities are currently making it significantly more difficult to assess the budgetary situation. The data available to date indicate that the off-budget entities recorded a sizeable surplus.<sup>11</sup>

Revenue rose by almost 8% over the year as a whole.<sup>12</sup> Tax revenue declined by 5% on ac-



count of the coronavirus crisis. Revenue received from public administrations, by contrast, saw substantial gains of 51%. This was chiefly due to government funds to be paid out as coronavirus assistance to enterprises and to local government. Compensation payments for unoccupied hospital beds forwarded from central government also made an impact. In addition, state governments made transfers from special funds to core budgets. These outflows were financed in part by loans taken up by the special funds and thus eased the strain on the

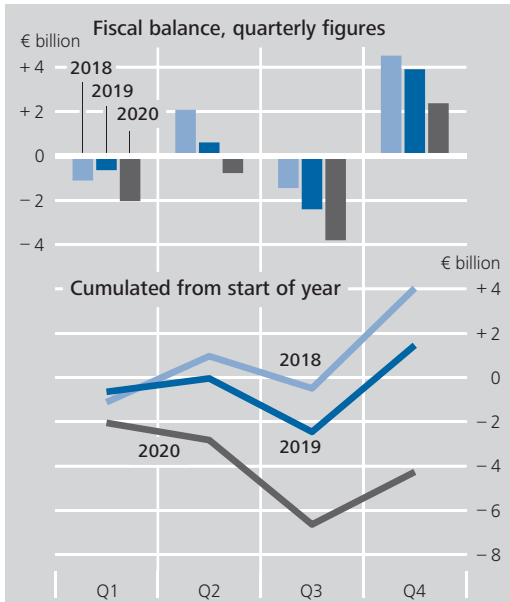
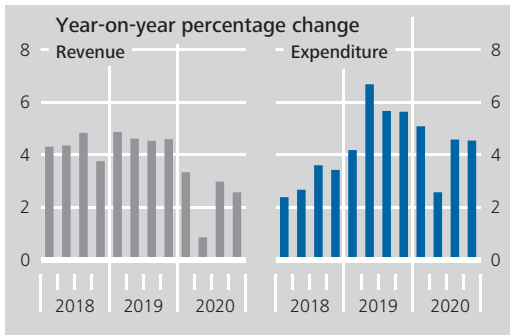
*Rise in revenue and expenditure chiefly due to transfers between public administrations*

<sup>10</sup> The figures are based on the monthly cash statistics on the core budgets.

<sup>11</sup> According to quarterly data, a core budget deficit of €25 billion was recorded after three quarters, vis-à-vis a surplus of €8 billion for off-budget entities.

<sup>12</sup> The changes to financial relations between central and state government agreed prior to the coronavirus crisis to take effect from 2020 had a negligible effect on state government finances – taken in isolation, the changes to the state government revenue-sharing scheme increased the states' total receipts. At the same time, however, transfers from central government stopped, and the increased share of local business tax transferred to state government expired.

### Finances of the German statutory pension insurance scheme\*



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

core budgets. Total expenditure went up by 21%, with payments to public administrations surging in particular (+36%). Additional transfers to local government played a major role here,<sup>13</sup> with central government payments to compensate for shortfalls in local business tax being almost doubled by state government payments of €5 billion. In addition, some federal states evidently prefinanced special funds, into which they incorporated coronavirus-related financial flows, on a large scale. Furthermore, other operating expenditure, in particular, rose markedly (+34%). It appears that as well as the procurement of personal protect-

ive equipment, transfers to enterprises were, in part, recorded under this item.

The coronavirus crisis will continue to place a strain on state government budgets in 2021. According to the official tax estimate of November 2020, receipts will be €20 billion lower than was expected a year earlier. Further shortfalls of just over €3 billion will result from legislative changes made in the intervening period, particularly the increase in child benefits and income tax cuts (Second Family Relief Act (*Zweites Familienentlastungsgesetz*)). Additional, albeit lower shortfalls are foreseeable following the tax decisions made by the coalition committee at the start of February. On the expenditure side, extensive financial aid could flow to local governments once again. The local governments are only able to absorb revenue shortfalls themselves to a limited extent. Therefore, the federal states are required to step in – in line with their fundamental responsibility to adequately furnish local governments with financial resources. Overall, the volatile local revenue base makes it difficult to provide steady financing for needs-based investment in local infrastructure. Aside from urgent crisis assistance, then, the federal states should call for a comprehensive reform of local government financing.<sup>14</sup>

*COVID-19 crisis continues to weigh on state government budgets this year*

Many federal states are taking out emergency loans this year, too. Some states still have reserves at their disposal – in prefinanced off-budget entities or off-budget entities with borrowing authorisation, for instance. As the crisis abates and the escape clauses cease to apply, budget consolidation measures are likely to become necessary – some of which might be substantial. Such measures differ in scale, not solely on account of the federal states' divergent budgetary situations. As well as the crisis-related annual repayment burdens, the volume

*Federal states with varying consolidation requirements after the crisis*

<sup>13</sup> See Deutsche Bundesbank (2021), p. 9.

<sup>14</sup> See Deutsche Bundesbank (2020c), pp. 10-11.

of reserves still available and scope for cyclically induced debt also vary from state to state.<sup>15</sup>

## ■ Social security funds

### Pension insurance scheme

*Significant deficit in 2020, but reserves remain high*

The German statutory pension insurance scheme concluded 2020 with a substantial deficit of almost €4½ billion. The year before, it had posted a surplus of €2 billion. The deficit was funded from the sustainability reserve, which decreased to €37 billion by the end of 2020 but still amounted to almost 1.6 times the scheme's monthly expenditure (around €32 billion over the statutory minimum of 0.2 times monthly expenditure).

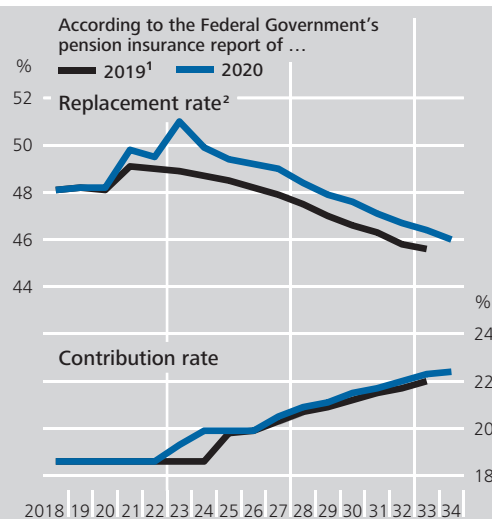
*Revenue growth weak, expenditure growth persistently steep*

Revenue went up by 2%. Contributions paid for recipients of short-time working and unemployment benefits compensated for 80% of contribution shortfalls from regular employee earnings. In addition, government funds rose markedly in line with adjustment rules. Expenditure saw renewed steep growth of 4%, with individual pensions being adjusted by 3½% on average across the year.

*Considerably higher deficit expected for 2021*

In the current year, expenditure is likely to continue rising more rapidly than revenue, resulting in a considerably higher deficit. In terms of pension expenditure, the relatively high adjustment of mid-2020 will produce a substantial increase on the year in the first half of 2021.<sup>16</sup> At mid-year, therefore, general pension adjustments<sup>17</sup> are unlikely, partly due to the crisis. An overall average annual increase in individual pension benefits of 2% can consequently be expected. In addition, the number of pensions is likely to increase markedly. Furthermore, the supplementary contribution rates to the statutory health insurance scheme, which are partially funded by the pension insurance scheme, are rising. The new basic pension is driving up administrative costs and pension spending; however, central government is to pay an add-

### German statutory pension insurance scheme: outlook for replacement rate and contribution rate



Sources: Federal Ministry of Labour and Social Affairs and Bundesbank calculations. **1** Using a comparable statistical basis: from 2021, the level reported here is higher than in the report of 2019 because it contains an estimated revision of compulsory contributions. **2** Standard pension (after 45 years of contributions with average pay) in relation to average earnings subject to compulsory insurance (both variables before taxes, but after deduction of the respective social security contributions due).

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ditional grant for the increased pension entitlements.<sup>18</sup>

Financial pressure on the pension scheme is likely to continue mounting significantly in the coming years, with the special rules in place for annual pension adjustments further exacerbating the underlying demographic pressure. This means that the replacement rate will probably be persistently higher than expected prior to the crisis; unlike the situation after the economic crisis of 2009, waived pension cuts will not be offset later by reduced rises. Based on the Federal Government's pension insurance

*Pension insurance report: contribution rate just below threshold in 2025; replacement rate way above guaranteed 48%*

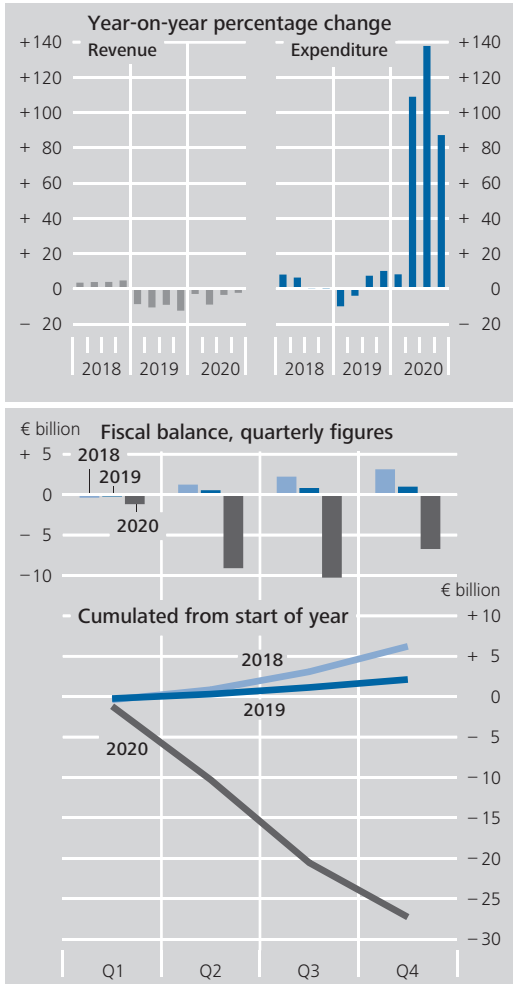
<sup>15</sup> For more details, see Deutsche Bundesbank (2020d), pp. 102-105.

<sup>16</sup> For more information on pension adjustments, see Deutsche Bundesbank (2020b), pp. 72-73.

<sup>17</sup> The fact that the eastern German level is to be gradually raised to the western German level by 2024 is driving up expenditure somewhat. Consequently, pensions will increase by 0.2% on average across Germany in mid-2021.

<sup>18</sup> Based on the information available thus far, this will not be adjusted to the expected increasing spending going forward.

### 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

report at the end of 2020, the replacement rate will be one percentage point higher in the longer term (see the chart on p. 81). The report anticipates that the reserve will erode rapidly over the coming years. The contribution rate will then make significant bounds from its current level of 18.6% to 19.3% in 2023 and 19.9% in 2024. According to the report, the maximum threshold of 20% will be slightly undershot in 2025, meaning that no additional government funds will be needed. The increasing financial pressure is set to make itself felt after 2025, too; under current law, the replacement rate will decrease further, contribution

rates will rise continuously, and government funds will see dynamic growth.

## Federal Employment Agency

The Federal Employment Agency has been making a crucial contribution to stabilisation during the coronavirus crisis. This is reflected in the large budgetary burden seen last year; in the core budget,<sup>19</sup> the Federal Employment Agency recorded a deficit of €27 billion, following a surplus of €2 billion the previous year. At end-2019, the free reserves stood at €26 billion. However, they could not be fully liquidated. Central government thus granted a loan of €7 billion to finance the budget, with the result that the reserves still totalled €6 billion at the end of 2020.<sup>20</sup>

Revenue fell by 4½%; the fact that the contribution rate had been lowered at the start of 2020 (from 2.5% to 2.4%) accounted for three percentage points of this drop. The situation was further compounded by crisis-related contribution shortfalls. These, in contrast to other branches of social security, are not being alleviated by contributions paid for recipients of short-time working and unemployment benefits.

The economic slump resulted in steeply rising expenditure (+84%, or €28 billion). Unemployment benefit payments climbed 37% (+€6 billion). Per capita benefit rates increased by only a moderate 1%. The number of unemployed, by contrast, rose by a steep 36%, thus reaching a comparable level to that of 2010. Payments for short-time working benefits multiplied to

*Very large deficit for 2020 as a whole*

*Revenue decreased on account of contribution rate cut and coronavirus crisis*

*Surge in expenditure owing to short-time working and unemployment benefits*

<sup>19</sup> Excluding the civil servants' pension fund. Transfers to the fund are thus recorded as expenditure here, lowering the core budget balance. These transfers have been suspended from the second quarter of 2020 until the end of 2021 because of the COVID-19 crisis. As a result, the fund posted a deficit of almost €½ billion for 2020, and its reserves declined to slightly less than €9 billion.

<sup>20</sup> Further reserves – financed by specific levies – were the insolvency benefit and winter compensation reserves, totalling around €1½ billion (€½ billion down on the year) and the civil servants' pension fund.

€23 billion (2019: just under €1 billion), including social contributions of €9 billion. The Federal Employment Agency has been paying these on behalf of enterprises as an exceptional crisis measure. This measure alone accounted for almost 2% of the contributions received by other branches of social security. From January to November 2020, an average of three million people were in short-time working arrangements, with the reduction in working hours amounting to 40%.

The Federal Employment Agency's budget plan, which was approved in December, envisages a

deficit of €9 billion in its core budget for the current year. Financing is to come from the remaining reserves and an additional central government grant of €3 billion. This would reduce the deficit significantly in net terms; according to the budget plan, contribution receipts are expected to rise substantially once more whilst expenditure on unemployment and short-time working benefits is set to decline strongly. However, the coronavirus restrictions have been stepped up and extended again since the budget was drawn up. Against this background, less favourable developments appear likely.

*Substantially lower deficit planned for 2021*

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