Public finances*

General government budget

2023 as a whole

Government finances improved in 2023

Germany's government finances improved last year. The deficit and debt ratios continued to decline. While the deficit ratio remained at 2% of gross domestic product (GDP), it was mainly the result of temporary relief measures. In addition, weak economic activity put a slight strain on budgets. In structural terms, the government budget was thus roughly balanced (for more details, see pp. 59 ff.). The debt ratio amounted to just under 65% at the end of the third quarter. Compared with its crisis peak of 69% in 2021, this constituted a swift and significant drop towards the reference value of 60%. The drop was due to the fact that, mainly as a result of price factors, nominal GDP grew more strongly than debt (denominator effect). The deficit and debt ratios remained moderate by EU standards.

Deficit ratio fell only because coronavirus response measures lapsed

The deficit ratio fell by ½ percentage point compared with 2022. However, this was not attributable to austerity policies, but instead to the lapsing of temporary coronavirus response measures amounting to almost 1½% of GDP. By contrast, support measures relating to the energy crisis burdened public coffers slightly more than in 2022 (see the chart on p. 60). A contributing factor here was that policymakers opted for broader transfers with virtually no means testing. This is especially true of the energy price brakes, but also of the exemption from taxes and social contributions applicable to inflation compensation bonuses. Weaker economic activity increased the deficit slightly. In addition, tax revenue was significantly weaker than would have been expected on the basis of macroeconomic developments and legislative changes. The preceding remarkably sharp rise in tax revenue in 2021 and 2022 was partially offset by the countermovement in 2023 (see p. 62). On the expenditure side, some items increased significantly; besides interest expenditure, these included military spending.

Outlook for 2024 and 2025

Deficit will also decline in 2024, but deterioration is likely in structural terms

The deficit is likely to decline further this year, but as things stand not below 1½% of GDP. The expected decline is due to the discontinuation of energy crisis support measures by the Economic Stabilisation Fund for Energy Assistance (ESF-E). Following the ruling of the Federal Constitutional Court in November 2023, central government decided not to extend them into 2024.[1] It is therefore withdrawing this assistance somewhat more quickly than previously planned. Outside of temporary influences of this nature, the fiscal balance is likely to deteriorate further. Consequently, a moderate structural deficit is to be expected.

Larger deficits, especially in Climate Fund and Armed Forces Fund

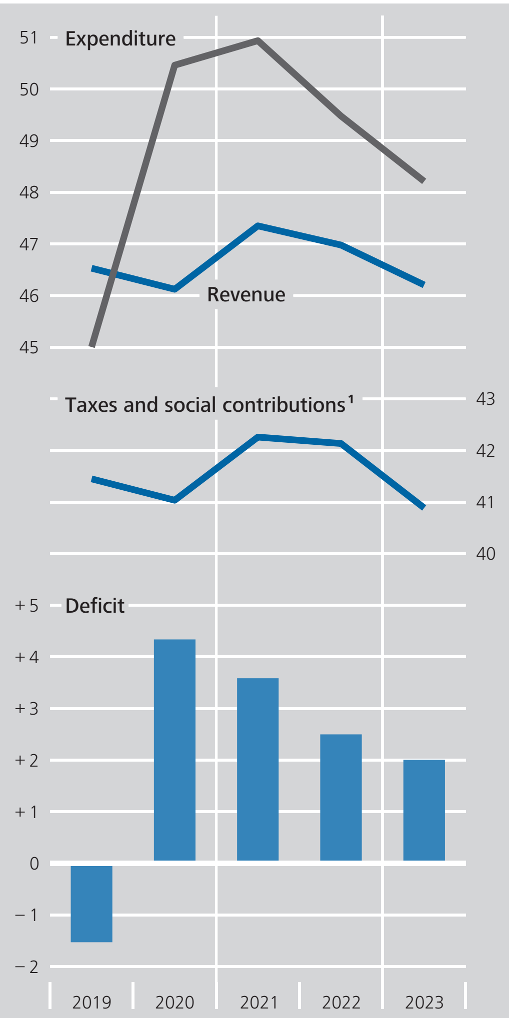
Compared with 2023, the structural deficit is likely to rise, mainly as a result of additional expenditure in the Climate Fund and the Armed Forces Fund. The smaller consolidation measures in other areas of central government finances are much too small to offset this in full. Furthermore, the deficits of state and local governments could expand somewhat. The recent higher price increases are likely to continue to push up spending, with the latest wage agreements and adjustments to civil servant pay significantly raising personnel expenditure.

The financial situation of the social security funds is also expected to deteriorate somewhat

* The section entitled "General government budget" relates to data from the national accounts and Maastricht debt. This is followed by reporting on budgetary developments (government finance statistics) in the areas for which data are available for 2023 as a whole.
1 For more information on the ruling, see Deutsche Bundesbank (2023a); on central government's plans for 2024, see pp. 68 f.

General government fiscal ratios*

As a percentage of GDP



* German general government budget as defined in the national accounts. **1** Taxes and social contributions plus customs duties and bank levies to the Single Resolution Fund.

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Slight deterioration in social security funds finances despite rising contribution rates

in 2024. Expenditure on pensions, healthcare and long-term care will grow more strongly in structural terms than the reference variables for contributions. In addition, central government will cut several grants, such as to the statutory health and pension insurance schemes. Additional revenue from higher contribution rates for long-term care insurance and health insurance will only partially offset the burdens. The overall contribution rate to the social security funds is likely to rise to almost 41% this year (2023: 40.5%).

Deficit is also likely to fall in 2025

From the current perspective, the general government deficit ratio looks set to fall again next year. Central government will then have largely used up its extensive budgetary reserves in the Climate Fund and core budget and will have to reduce deficits in those areas.[2] In addition, the last temporary support measures will expire in 2025 (in particular the exemption from taxes and social contributions applicable to inflation compensation bonuses). Compared with this relief, factors placing a burden on the budget, such as an increasing deficit in the Armed Forces Fund, are likely to be of less significance.

Debt ratio on downward path

The debt ratio is expected to decline further in 2024 and 2025. While nominal GDP growth is not expected to be as strong as in 2023 due to slowing price dynamics, it is anticipated that the deficit will be lower. However, the decline in the debt ratio will be smaller if central government takes out loans to build up a generational capital fund to ease the burden on the statutory pension insurance scheme.

Reform of EU fiscal rules

Reform of EU fiscal rules: requirements will change for Germany, too

The planned reform of the EU fiscal rules could bring about significant changes in the European rules applicable to Germany as of next year (for information on the reform, see p. 65).[3] As things currently stand, it looks like Germany will have to limit its structural deficit ratio to a maximum of 1½% under the reformed rules.[4]

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2 The debt brake limits net borrowing. In 2024, central government is financing parts of the deficit using reserves. By doing so, it can run a correspondingly larger deficit and nevertheless comply with the ceiling on net borrowing it has calculated. If the reserves are used up in 2025, the deficit will have to fall accordingly in order to continue to comply with the ceiling.
3 In 2024, Germany is likely to comply with the EU rules, partly because support measures relating to the energy crisis are now expiring earlier than initially planned (this had been requested by the European Commission; see European Commission (2023)). The Independent Advisory Board of the Stability Council also assumes that Germany will comply with the EU requirements (see Independent Advisory Board of the Stability Council (2024)).
4 The structural deficit for the purposes of the EU rules is calculated using a method different to the Bundesbank's estimation approach. For example, the European Commission has reported a significantly larger structural deficit for Germany in recent years. This is mainly due to the fact that it hardly excludes any temporary crisis measures.

German government budget in times of crisis – developments in the period 2020 to 2023[1]

The COVID-19 pandemic and the energy crisis had a massive impact on the German general government budget. In 2019 – prior to the outbreak of the pandemic – a surplus of 1½% of gross domestic product (GDP) was recorded. In the first year of the pandemic, which saw substantial restrictions on economic activity in some cases, the deficit ratio was just over 4%.[2] Since then, it has been gradually declining. Based on initial figures (from mid-January 2024), it stood at 2% in 2023.

This box takes a closer look at the developments in the government budget since 2019. For this purpose, general government revenue and expenditure in the national accounts are broken down into temporary and structural shares. Here, factors with a temporary influence include cyclical effects, crisis measures, and other one-off effects. The indirect effects of the pandemic, which are more difficult to capture, have not been factored out of the structural balances. For instance, expenditure on non-coronavirus-related medical treatment decreased and revenue from fees was lost due to the use of government facilities being restricted at times. As the Bundesbank uses its own analytical methods and estimates, the data on structural balances differ from those of other institutions.[3] Revisions to the national accounts data and a changed macroeconomic outlook will have an effect on the results presented below.

Cyclical deficits caused by economic downturn

In 2019, the influence of cyclical factors on the government budget was still clearly positive. However, it subsequently turned strongly negative in 2020 (see the table on p. 63, item 2). The economic downturn resulted primarily in a decline in tax receipts and increased expenditure on short-time work. It had a much more moderate impact on social security contributions and spending on unemployment benefits. The economy rebounded in 2021 and 2022. In 2023, however, the cyclical impact on the deficit was once again slightly negative.

Temporary measures were a considerable drag

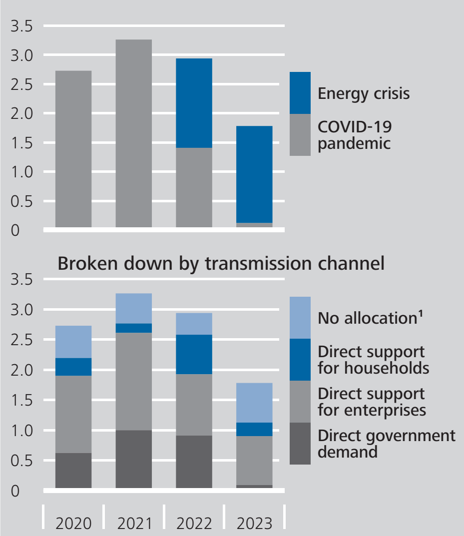
Temporary crisis-related measures weighed more heavily on the government budget than cyclical factors (see the chart on p. 60). In the period from 2020 to 2022, these measures accounted for an annual volume of around 3% of GDP. In 2022, new relief measures in response to the energy crisis virtually cancelled out the reduced coronavirus measures. Last year, the remaining coronavirus-related spending for 2022 largely came to an end. The total volume of support measures fell to 1¾% in 2023.

The corporate sector received the largest share of the temporary support measures.

1 See Deutsche Bundesbank (2006) for notes on the analytical approach used here. The analysis relates to data from the national accounts.
2 The last time the general government budget recorded a greater deterioration was in 1995: this was due to the assumption of debt totalling €122 billion (6½% of GDP), which affected the deficit at the time – largely from the Treuhand agency, which was responsible for the privatisation and winding-up of state-owned enterprises and formed part of the corporate sector.
3 For example, the Federal Government and the European Commission generally do not factor out the support measures temporarily put in place during these years from the structural government budget, which is why the levels and changes they report differ considerably from the data presented here.

Temporary fiscal measures affecting the deficit that are directly linked to the COVID-19 pandemic and the energy crisis*

As a percentage of GDP



* Bundesbank estimate. This definition does not include longer-term fiscal projects. **1** VAT rate and energy tax rate cuts, revenue shortfalls due to employers' one-off payments being exempt from income tax and social contributions, stabilisation of the renewable energy (EEG) levy and reduction in fares for local public transport (€9 ticket).

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These included direct transfers (primarily coronavirus bridging aid from 2020 to 2022), payments to offset losses (primarily for gas trading companies in 2022), the majority of the energy price brakes (2023), and the assumption of social contributions for short-time work from 2020 to 2022.[4] In addition, special tax arrangements boosted corporate liquidity. In essence, these arrangements merely had the effect of shifting tax revenue along the time axis. Examples include the deferral of special advance VAT payments and an increased scope for loss carrybacks.[5] Households primarily received one-off energy price allowances (2022), transfers from the energy price brakes (2023), and bonus child benefit payments (2020 to 2022). VAT rates were temporarily lowered for enterprises and households (generally in the second half of 2020, on restaurant meals from July 2020 until the end of 2023, for gas and heating from autumn 2022, currently set to expire at the end of March 2024), as were energy tax rates (summer 2022). In addition, in 2021, the government employed subsidies to stabilise the renewable energy (EEG) levy. Moreover, since the end of 2022 up to and including 2024, inflation compensation paid out to workers has been exempt from taxes and social contributions. An overview of the most significant measures can be found on p. 61.

Real government consumption also saw a significant temporary increase. For example, the COVID-19 pandemic resulted in a significant amount of healthcare-related government spending. Initially, this was on personal protective equipment, additional intensive care capacities and PCR tests, subsequently also on vaccinations, and finally on tests for the general public. Moreover, central government paid temporary compensation to hospitals so that they could keep empty beds available.

Finally, in addition to refunds for pandemic-related payments, central government paid extensive special grants to the social security funds. Without these, the funds would have needed to raise their contribution rates to a much higher level in order to close funding gaps.

Temporary non-crisis-related influences

Temporary one-off non-crisis-related influences also had an impact; these are factored out of the structural balance. Specifically, this relates to two effects that increased the deficit in 2021 (each of which accounted for around 0.1% of GDP). First, the

4 Expenditure on short-time working benefits is largely regarded as a cyclical influence.
5 Added to this were other government support measures such as loan guarantees, loans and equity participations in response to the coronavirus pandemic. These were not reflected as financial transactions in the national accounts deficit, but in the debt level only.

government paid one-off compensation to energy companies in the context of Germany's moving away from nuclear power. Second, it refunded interest paid on tax debts because the Federal Constitutional Court ruled that the interest rate was too high.[6]

Moderate deterioration in the structural balance during the crises

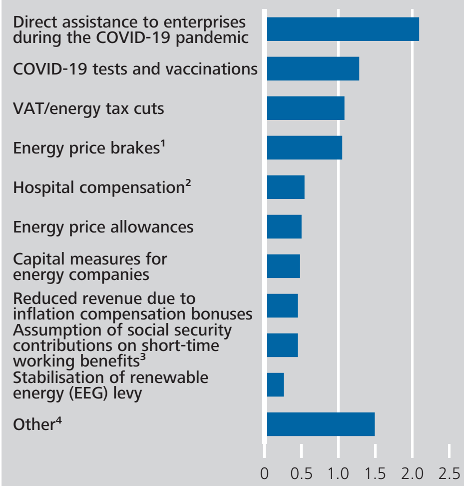
The structural balance is obtained by deducting the cyclical effects, temporary measures and influences described above from the unadjusted balance.

Over the course of the crises, the structural situation of the government budget underwent a moderate deterioration (see the table on p. 63, item 4): having recorded a surplus of ½% of GDP in structural terms in 2019, it was roughly balanced in 2023. The expenditure ratio increased at a slightly steeper rate than the revenue ratio (the structural ratios are presented here and below).

The structural general government budget ratio fluctuated strongly over time. This is due in large part to the tax ratio. The models are not well suited to explaining its upward and downward movements (see item 8.4). In the case of non-tax revenue (primarily sales) and individual categories of expenditure (primarily subsidies), interim changes in ratios are due in part to the fact that it is not always possible to identify temporary influences conclusively. However, this is virtually irrelevant when it comes to comparing the development of the structural general government budget in 2023 with 2019. The erratic upward and downward fluctuations largely balance each other out over this period.

Funding volume of key temporary support measures affecting the deficit during the COVID-19 pandemic and the energy crisis*

As a percentage of GDP in 2023



* Bundesbank estimate of reduced/increased government revenue from 2020 to 2023. **1** Including payments for December 2022 energy bill installments. **2** Compensation payments for keeping beds unoccupied. **3** Excluding expenditure on short-time work, as this is mostly counted as cyclical spending. **4** Additional expenditure on health protection measures, tax measures, social transfers and grants.

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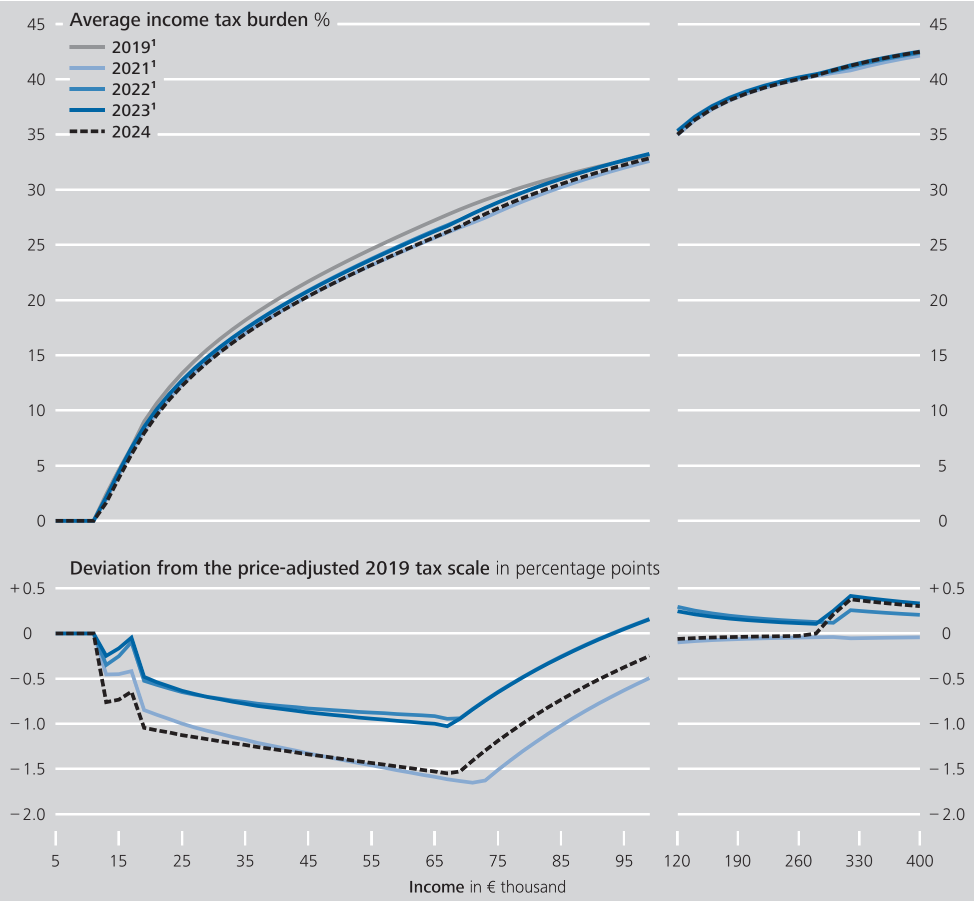
In terms of revenue, the social security contributions ratio increased because contribution rates were raised: the average supplementary contribution rates for health insurance institutions rose each year from 2020, while the contribution rates for unemployment and long-term care insurance went up in 2023. As a result, the overall social contribution rate was 40.5% last year, compared with 39.7% in 2019.

The tax ratio fluctuated significantly and was down slightly on 2019. Although bracket creep had a positive impact – especially in the past two years, due to high inflation (see item 8.1) – tax cuts were more than twice as substantial overall (see item 8.3). With regard to income tax (including the solidarity surcharge), legislators have

6 The national accounts record payments based on court rulings as government capital transfers as soon as the ruling enters into legal force and it becomes possible to gauge the level of reimbursement.

Price-adjusted income tax scales and deviation from the 2019 tax scale*



Sources: Federal Ministry of Finance and Bundesbank calculations. * Based on the income tax scale for individually assessed taxpayers. The tax scales are shown inclusive of the respective solidarity surcharge. They are adjusted using the deflator for private consumption from the national accounts (for 2024: Bundesbank projection). To this end, incomes are deflated using the inflation rate from the respective year in which the tax scale applied through to 2024. The respective applicable tax rates are then applied. If tax scales always shifted exactly in line with the inflation rate, the scales would overlap exactly. **1** Price-adjusted.

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lowered the overall scale more than the tax burden has increased due to bracket creep (see the chart above). This is essentially due to the fact that the solidarity surcharge was completely or partially abolished for lower and medium income households in 2021. In 2022 and 2023, the price-adjusted tax scales were again noticeably higher for a time than in 2021. This is because legislators only brought the tax scale into line with inflation for the respective year in the subsequent year. This means that when inflation rates rise, the price-adjusted tax burden also goes up. This year, the scale will drop back down towards the level recorded in 2021. One exception to this is the section of the scale above the threshold for the top-income tax bracket. Legislators have not brought this into line with inflation recently.[7]

7 In addition to the above-mentioned time lag, another factor is that the scales are adjusted on the basis of inflation rate estimates. For more details on how legislators generally bring the income tax rate into line with inflation, see Deutsche Bundesbank (2022a). The top-income tax rate refers to the increase in the tax rate from 42% to 45% for the portion of taxable income that exceeds €277,825 for individually assessed taxpayers.

Structural development of the government budget*

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

Item	2020	2021	2022	2023	2023 in relation to 2019
1 Unadjusted fiscal balance[1]	− 5.9	0.8	1.1	0.5	− 3.5
2 Cyclical component[1]	− 1.9	0.5	0.4	− 0.2	− 1.2
3 Special temporary effects[1]	− 2.7	− 0.8	0.4	1.2	− 1.8
4 Fiscal balance	− 1.2	1.0	0.2	− 0.5	− 0.5
5 Interest payable[2]	− 0.2	0.0	0.1	0.2	0.1
5.1 due to change in average interest rate	− 0.2	− 0.1	0.1	0.2	0.1
5.2 due to change in debt level	0.0	0.0	0.0	0.0	0.0
6 Primary balance	− 1.4	0.9	0.3	− 0.3	− 0.5
7 Revenue	− 0.4	1.2	0.3	− 0.9	0.2
8 Taxes and social contributions	− 0.1	0.9	0.1	− 1.1	− 0.2
8.1 Fiscal drag[3]	0.1	0.1	0.2	0.3	0.7
8.2 Decoupling of macroeconomic reference variables from GDP	0.0	0.0	0.0	− 0.1	− 0.1
8.3 Legislative changes	− 0.2	− 0.5	− 0.5	− 0.5	− 1.6
8.4 Residual	0.0	1.3	0.4	− 0.8	0.9
9 Social contributions	− 0.1	0.2	0.2	0.0	0.3
10 Other revenue[4]	− 0.2	0.1	− 0.1	0.2	0.0
11 Primary expenditure	1.0	0.3	− 0.1	− 0.6	0.6
12 Social payments	0.1	0.2	− 0.1	− 0.5	− 0.2
13 Subsidies	0.3	0.0	− 0.1	− 0.2	0.0
14 Compensation of employees	0.1	0.0	− 0.1	− 0.2	− 0.3
15 Intermediate consumption	0.1	− 0.2	0.0	0.4	0.3
16 Gross fixed capital formation	0.2	− 0.1	0.1	0.0	0.2
17 Capital transfers	0.1	0.2	0.3	0.1	0.7
18 Other expenditure[5]	0.2	0.1	− 0.1	− 0.2	0.0
Memo item:					
20 Real trend GDP[6]	0.9	0.8	0.8	0.8	3.4
21 GDP deflator[6]	1.9	3.0	5.3	6.6	17.8

* The structural figures are derived by adjusting for cyclical influences and special temporary effects (primarily crisis measures). For analytical purposes, 2023 was adjusted for a statistical reclassification: in 2023, local public transport was reassigned from the corporate sector to the general government sector. Due to this reclassification, general government revenue and expenditure in 2023 each rose by ¼% of GDP. This increase will appear only temporarily in the national accounts, as with the general revision in August, local public transport will be assigned to the general government sector for previous years, too. **1** Change in the ratio to GDP compared with previous year. **2** 2023 breakdown estimated, as end-year debt level is not yet available. **3** 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. **4** Other current transfers receivable, sales and total capital revenue (excluding capital taxes). **5** Other current transfers payable, other net acquisitions of non-financial assets. **6** Year-on-year percentage change.

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The major fluctuations in the tax ratio are largely the result of taxes on profits. In 2021 and 2022, after adjusting for legislative changes, they significantly outstripped trend growth in their macroeconomic reference variables (see item 8.4). However, a significant countermovement took hold in 2023, which partially offset excess growth. In 2023, other major types of tax such as wage tax and VAT also recorded weak growth. In fact, real estate acquisition tax revenue fell sharply (see p. 66 for more details).

In 2023, the ratio of other revenue was broadly in line with 2019. Although interest income has risen significantly recently, the fact that the Bundesbank has not transferred any profits to central government since 2021 has reduced revenue.

The expenditure ratio increased noticeably in comparison to 2019. It initially rose sharply in the period leading up to 2021, when it reached its highest level since Germany's reunification, before falling again somewhat in 2022 and 2023. The main reason for this decline was that major expenditure categories are lagging behind inflation. Consequently, nominal trend GDP in the denominator of the ratio (see items 20 and 21) is growing faster than expenditure in the numerator due to high inflation.[8] Given that more and more expenditure is likely to catch up, the expenditure ratio is expected to rise again this year.

The rise in the expenditure ratio was mainly due to the significant increase in government spending on climate action. This was reflected in particular in higher capital transfers. These include grants from the Climate Fund for energy-efficient building refurbishment and e-mobility, for instance. The intermediate consumption ratio also grew strongly – especially in 2023.

Although the interest expenditure ratio is still low in a longer-term comparison, it started rising again for the first time in many years in 2022. This was due to inflation. Expenditure on inflation-linked securities increased considerably in 2022 and 2023 (see also p. 71). By contrast, the higher debt ratio was virtually irrelevant for interest expenditure over the period as a whole. First, the debt ratio at the end of 2023 was no longer much higher than in 2019. Second, the rate of interest on new debt remained very low on average.

Social benefits and employee compensation ratios have declined considerably in recent years. These expenses largely adjust to significantly increased price levels only with a time lag.[9] For instance, this applies to wages and salaries within the public sector, and to pension adjustments.

8 Trend nominal GDP in the denominator of the ratio is calculated as the product of the unadjusted GDP deflator and the trend in real GDP.
9 For the effects of inflation on general government budgets in euro area countries, see Bańkowski et al. (2023).

In addition, the debt ratio will need to fall by an average of ½ percentage point annually until it reaches the reference value of 60%. Seen from the present perspective, Germany will comply with these requirements. However, additional requirements could be imposed to make provisions for the increasing burdens related to population ageing. Overall, it is not yet entirely clear what exactly the reformed EU rules will mean for Germany.

Debt brake strengthened

Change in debt brake under discussion

Following the ruling of the Federal Constitutional Court in November 2023, the binding effect of the German debt brake on fiscal policy is stronger once again. At present, there are various proposals to loosen the debt brake through amendments to Germany's constitution, or Basic Law. Some proposals aim to broaden the leeway for borrowing in general. Others want exclusively investment expenditure or transformation tasks, for example, to be financed through additional debt. Two main approaches are being discussed: one in which the debt brake would be replaced by a golden rule again, and another in which an additional debt-financed special fund would be introduced in the Basic Law alongside the debt brake.

With binding fiscal rules, somewhat broader leeway for borrowing is justifiable

The Bundesbank considers effective fiscal rules important to safeguard sound government finances. Prior to the ruling of the Federal Constitutional Court, the debt brake had been softened by means of the escape clause. This is also why the Bundesbank was already considering in the spring of 2022 how the debt brake could be reformed in a way that would safeguard stability.[5] The thinking was to have a rule with a stronger binding effect again and tie it to greater leeway for deficits.[6] This also

5 See Deutsche Bundesbank (2022b).
6 This is very much in line with the latest proposals by the German Council of Economic Experts (2024).

The reform of the EU's fiscal rules

In December 2023, the Economic and Financial Affairs Council (ECOFIN) agreed on new regulations concerning the EU's fiscal rules. Although the new rules still have to be negotiated with the European Parliament and finalised, the basic principles underlying them have now been defined.

The ECOFIN agreement contains important fiscal anchors. For example, the fact that the 3% limit for the deficit ratio will be maintained and remain backed by sanctions is welcome. For Member States with deficit or debt ratios above the respective reference value, moreover, the new rules envisage a more ambitious budgetary objective than the 3% limit. These countries will be obliged to achieve a structural deficit ratio of no more than 1.5% over the medium term. Another welcome development is that foreseeable ageing-related costs are to be taken into account.

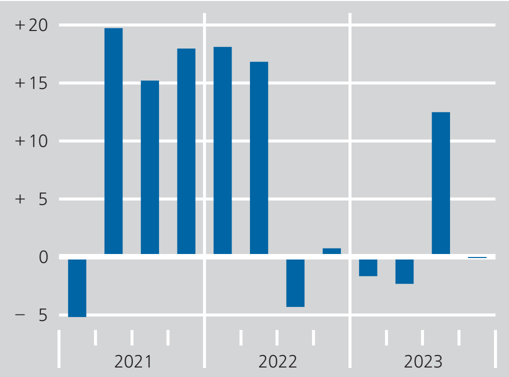
However, a number of aspects of the reform are problematic. These include the wide discretionary scope in many instances, and the fact that the annual budgetary limits rely on assumptions. The European Commission is to negotiate these assumptions bilaterally with each Member State. At the same time, the rules are very complicated. Even with great effort, third parties will struggle to follow how the final limits were agreed upon and whether they have been adhered to. This will make public discussion of how the rules are implemented more difficult, risking the loss of an important pillar of oversight. This, too, could encourage the setting of unambitious annual limits, which would delay any necessary consolidation.

Moreover, transitional provisions may decisively reduce the pace of consolidation in the coming years. For a transitional period following the launch of the new rules, some elements of the basic rules will be watered down. The present high debt ratios could thus become further entrenched or even rise.

All in all, there is a risk that the new rules will barely contribute at all to the objective of sound public finances. Experience has shown that governments have little interest in being fiscally constrained by budgetary rules. The broad discretionary scope permitted in the rules' implementation plays into this tendency. This makes it all the more important for the European Commission and ECOFIN to translate the rules into ambitious requirements and press for Member State compliance. Only then are we likely to see a rapid fall in high debt ratios, in particular. Strict application of the rules would also boost capital markets' confidence in the soundness of public finances.

Tax revenue*

Year-on-year percentage change, quarterly figures



Source: Federal Ministry of Finance. * 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.
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fits in with the current debate: German fiscal rules should prescribe budget ceilings to ensure that Germany generally complies with the 60% reference value for the debt ratio and that it returns to compliance swiftly if it overshoots this threshold. In this context, it would be possible to earmark some borrowing for certain government expenditure items. This could be done, for example, using a capped golden rule, as discussed by the Bundesbank, under which net government investment could be financed by borrowing up to a fixed ceiling.[7] A special fund with its own credit limit in Germany's Basic Law could be designed in such a way that it expands the leeway for a deficit in a comparable way; in this respect it would not contradict these basic considerations. It should be borne in mind that Germany must, at the same time, comply with the EU budget rules. In other words, the tighter of the two sets of rules will determine the leeway for deficits.

Budgetary development of central, state and local government

Tax revenue

2023 as a whole

Tax revenue increased moderately in 2023 – slightly undershooting official tax estimate

Tax revenue[8] grew by 2% year on year in 2023, or €15 billion (see the adjacent chart and the table on p. 67). On the one hand, high inflation led to a significant increase in the macroeconomic reference variables for taxes. Additional revenue was also generated through progressive taxation. On the other hand, tax cuts markedly dampened the increase, which, overall, was €3 billion, or 0.3 percentage point lower than expected in the October tax estimate.[9]

Tax cuts dampened wage tax revenue and …

Wage tax revenue increased by 4%, or €9 billion. This increase was 3 percentage points lower than the growth in the relevant macroeconomic reference variable of gross wages and salaries. That is because, on balance, tax cuts outweighed the boosting effects of progressive taxation. Compared with 2022, the disappearance of energy price allowances (€10 billion) increased tax revenue. The allowances had been paid out of wage tax revenue for the most part. More significant, however, were permanent tax cuts. Above all, legislators adjusted the income tax scale to compensate for the high bracket creep of 2022. In addition, one-off wage payments were in many cases made in the form of tax-free inflation compensation bonuses. Last but not least, the significant increase in child benefits, which are paid out of wage tax revenue, had a dampening effect.

7 The cap is fundamental to a stability-oriented design; without it, there are strong incentives to broadly define where investment should go and thus undermine the rule.
8 Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the year.
9 For more details on the official tax estimate, see Deutsche Bundesbank (2023b), pp. 63 ff.

Tax revenue

Type of tax	Full year 2022 € billion	2023 € billion	2023 Year-on-year change € billion	2023 Year-on-year change %	Estimate for 2023[1] Year-on-year change in %	Q4 2022 € billion	2023 € billion	2023 Year-on-year change € billion	2023 Year-on-year change %
Tax revenue, total[2]	814.9	829.8	+ 14.9	+ 1.8	+ 2.2	221.5	221.3	− 0.2	− 0.1
of which:									
Wage tax[3]	227.2	236.2	+ 9.0	+ 4.0	+ 4.7	67.2	64.7	− 2.6	− 3.8
Profit-related taxes	162.9	163.0	+ 0.1	+ 0.1	+ 0.1	42.4	42.4	− 0.0	− 0.1
Assessed income tax[4]	77.4	73.4	− 4.0	− 5.2	− 5.8	21.7	21.2	− 0.5	− 2.4
Corporation tax[5]	46.3	44.9	− 1.5	− 3.2	− 0.4	13.2	11.8	− 1.3	− 10.2
Non-assessed taxes on earnings	32.6	36.4	+ 3.8	+ 11.8	+ 12.7	6.4	6.7	+ 0.2	+ 3.8
Withholding tax on interest income and capital gains	6.6	8.4	+ 1.8	+ 27.5	+ 11.3	1.1	2.7	+ 1.6	+ 142.8
VAT[6]	284.9	291.4	+ 6.5	+ 2.3	+ 2.9	72.3	74.5	+ 2.2	+ 3.0
Other consumption-related taxes[7]	88.4	93.3	+ 4.9	+ 5.5	+ 5.4	26.1	27.1	+ 1.0	+ 3.8

Sources: Federal Ministry of Finance, Working Party on Tax Revenue Estimates and Bundesbank calculations. **1** According to official tax estimate of October 2023. **2** 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. **3** Child benefits and subsidies for supplementary private pension plans deducted from revenue. **4** Employee refunds and research grants deducted from revenue. **5** Research grants deducted from revenue. **6** VAT and import VAT. **7** Taxes on energy, tobacco, insurance, motor vehicles, electricity, alcohol, air traffic, coffee, sparkling wine, intermediate products, alcopops, betting and lotteries, beer and fire protection.

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… VAT revenue

In 2023, VAT receipts rose by only 2½%, which was 3 percentage points less than nominal private consumption – its most important macroeconomic reference variable. Tax cuts significantly reduced growth here. These were mainly the temporarily lower tax rates on natural gas and district heating. In addition, it appears that tax revenue in 2022 might have been inflated owing to back-payments of taxes from the coronavirus crisis.

Decline in income tax and corporation tax, dynamic growth in investment income tax

On the whole, profit-related taxes moved sideways. Assessed income tax and corporation tax both recorded declines. In addition to weak real economic developments, legislative changes were also a factor in this. These legislative changes mainly concerned income tax, with the aforementioned compensation for bracket creep. By contrast, non-assessed taxes on earnings (in particular dividend taxation) and withholding tax on interest income and capital gains recorded dynamic growth.

Revenue from real estate acquisition tax down sharply

The downturn in the real estate sector put a dampener on real estate acquisition tax, which flows into state budgets. Revenue was down by 29%, or €5 billion, compared with 2022.[10] This reduced overall revenue growth by ½ percentage point.

Outlook for 2024

Tax estimate: significant revenue growth in 2024

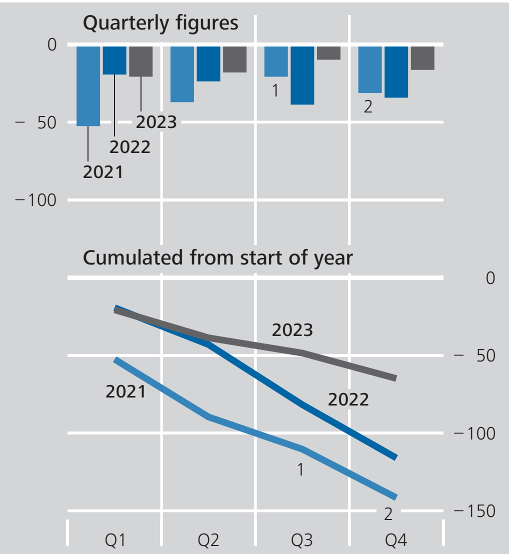
For the current year, the official tax estimate of last October expected tax revenue to rise more sharply than in 2023, with the macroeconomic reference variables developing somewhat less favourably. On balance, though, the shortfalls due to legislative changes are significantly lower than in 2023:

– At the beginning of 2024, legislators adjusted the income tax scale to a similar extent as in the previous year.

10 See also Table X.7 in the Statistical Section of this Monthly Report.

Fiscal balance of central government budget*

€ billion



Source: Bundesbank calculations based on data from the Federal Ministry of Finance. * Excluding off-budget entities. Not adjusted for financial transactions or cyclical effects. **1** The transfer of €16 billion from the core budget to the Flood Relief Fund was corrected by the removal of €14 billion in reserves following the Federal Constitutional Court's ruling in late 2023. **2** Excluding the transfer of €60 billion from the core budget to the Climate Fund, which the Federal Constitutional Court deemed unconstitutional in its ruling of 15 November 2023.
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– In the area of indirect taxes, there is a net increase in revenue. Although electricity tax for the manufacturing sector fell to the European minimum rate, the reduction in VAT on food in restaurants came to an end at the beginning of 2024. Furthermore, VAT on natural gas and district heating is expected to rise again at the end of March.

– In addition, profit-related taxes are now generating additional revenue as a result of write-offs being made at an accelerated pace in recent years.

– The share of gross wages and salaries paid as tax and social contribution-exempt inflation compensation bonuses is likely to decline.

Revenue expectations for 2024 noticeably lower than official tax estimate

However, tax revenue is likely to be significantly lower than forecast in the latest official tax estimate. This is due, first of all, to lower revenue as a result of legislative changes implemented in the intervening period. The aforementioned reduction in electricity tax is particularly significant in this regard. There are also plans to further increase the income tax allowances. In addition, limited shortfalls may yet arise as a result of the Growth Opportunities Act *(Wachstumschancengesetz),* which is currently still the subject of a mediation procedure between the Bundestag and the Bundesrat. Second, the lower-than-expected tax revenue in 2023 is likely to partly spill over into 2024. Third, economic growth could be lower than assumed in autumn.

Central government finances

Overview for 2023: central government including off-budget entities

2023: central government's overall deficit down substantially and lower than most recently envisaged

Central government's initial response to the ruling of the Federal Constitutional Court of November 2023 was to adopt a supplementary budget for 2023. This reduced the planned central government deficit (including off-budget entities) from an original €232 billion to €135 billion (see the table on p. 69, item 21). The deficit[11] was ultimately much lower still, at €88 billion (ibid.). The off-budget entities, in particular, closed the year more favourably than in the adjusted plans, especially the Climate Fund. In addition, special funds with no figures in the central government budget borrowing plan recorded considerable surpluses. Compared with 2022, the total central govern-

11 Besides the core budget, central government off-budget entities that use the single-entry system and for which data are already available are included here (see pp. 72 f.). These comprise, in particular, (i) the ESF-E, (ii) the off-budget entities relevant to the debt brake up to 2021, and (iii) the Armed Forces Fund (see the table on p. 69, items 16, 17 and 20). In addition, the reporting group for off-budget entities includes, above all, (iv) the other funds with figures in the central government budget borrowing plan (special funds for making provisions for redemptions and for extending childcare, item 18, ibid.), as well as (v) entities with no published borrowing plan figures (thus not counting towards the planned deficit), such as the precautionary fund for civil servants' pensions (item 19, ibid.). In particular, the bad bank FMSW, the fund for the disposal of nuclear energy waste, the motorway company and the development aid company GIZ are completely excluded.

Key central government budget data*

€ billion

	Item	Actual 2022	Target 2023	Supplementary budget target 2023	Actual 2023 (as at January 2024)	Draft 2024 (as at August 2023)	Target 2024
1.	Expenditure of central government budget (CGB)[1] of which:	480.7	476.3	461.2	457.1	445.7	476.8
1.a	Investment	46.2	71.5	61.1	55.0	54.2	70.5
1.b	Global spending increases/cuts	–	– 6.9	– 11.9	–	– 9.7	– 10.5
2.	Revenue of CGB[1,2] of which:	364.7	389.9	389.7	392.2	427.7	427.5
2.a	Tax revenue[3]	337.2	358.1	356.3	356.1	375.3	377.6
2.b	Global revenue increases/shortfalls	–	– 4.9	– 4.9	–	1.4	– 2.0
3.	Fiscal balance of CGB (2.-1.)	– 116.0	– 86.4	– 71.5	– 64.9	– 18.0	– 49.4
4.	Coin seigniorage of CGB	0.1	0.2	0.2	0.2	0.1	0.2
5.	Transfer to (–) / withdrawal from reserves (+) in CGB	0.5	40.5	43.8	37.5	1.4	10.2
6.	Net borrowing (–) / repayment (+) of CGB (3.+4.+5.)	– 115.4	– 45.6	– 27.4	– 27.2	– 16.6	– 39.0
7.	Cyclical component in the budget procedure[4]	– 1.8	– 15.3	– 5.5	– 7.1	– 2.4	– 7.7
8.	Balance of financial transactions of CGB	– 4.1	– 17.7	– 7.7	– 7.7	– 0.6	– 16.9
9.	Structural net borrowing (–) / repayment (+) (6.-7.-8.)	– 109.5	– 12.6	– 14.2	– 12.4	– 13.5	– 14.4
10.	Amount exceeding limit in CGB (13.-9.)	97.0	–	1.6	[5] 1.4	–	–
11.	Amount exceeding limit incl. Economic Stabilisation Fund for Energy Assistance (ESF-E) (10.-15.)	276.4	–	44.8	42.9	–	–
12.	Memo item: Amount exceeding limit with balance of off-budget entities (10.-16a.-17.)	106.7	142.5	60.8	46.4	51.5	34.5
13.	Standard upper limit: Structural net borrowing (0.35% of GDP)[6]	– 12.5	– 12.6	– 12.6	– 12.6	– 13.5	– 14.4
14.	Structural balance of CGB (3.-7.-8.)	– 110.1	– 53.4	– 58.3	– 50.2	– 15.0	– 24.8
14.a	As before, with estimate of potential output acc. to 2023 autumn forecast	– 111.2	– 57.5	– 52.6	– 46.0	– 9.7	– 24.8
15.	Structural net borrowing of ESF-E	– 179.4	–	– 43.2	– 41.5	–	–
16.	Deficit of ESF-E	– 30.2	– 121.2	– 43.2	– 41.5	– 13.9	–
16.a	Deficit of ESF-E excluding financial transactions	– 9.7	– 106.0	– 43.2	– 41.5	– 13.9	–
16.b	ESF funds remaining thereafter	169.8	48.6	–	–	34.7	–
17.	Balance of special funds (SFs) relevant to the debt brake prior to 2022[7]	4.9	– 21.4	– 16.0	– 3.5	– 37.6	– 34.5
17.a	Climate and Transformation Fund	5.3	– 14.1	– 14.1	– 1.7	– 29.2	– 28.7
17.b	2013 Flood Relief Fund	– 0.2	– 0.2	– 0.2	– 0.2	– 0.2	– 0.2
17.c	Fund to Promote Municipal Investment	– 0.7	– 1.0	– 1.0	– 0.6	– 0.9	– 0.9
17.d	Digitalisation Fund	2.1	– 2.7	– 0.8	– 1.1	– 4.2	– 4.1
17.e	Fund for Primary School-Age Childcare Provision	– 0.1	– 0.4	0.0	0.0	– 0.4	– 0.7
17.f	2021 Flood Relief Fund	– 1.6	– 3.0	0.0	0.0	– 2.7	–
18.	Balance of SFs for making provisions for repayment and for extending childcare	4.4	5.5	4.1	4.0	3.0	2.2
19.	Balance of other SFs without own constitutional rules[8]	– 9.9	–	–	23.9	–	–
20.	Balance of Armed Forces Fund	–	– 8.4	– 8.4	– 5.8	– 19.2	– 19.8
20.a	Borrowing authorisation remaining thereafter	100.0	91.6	91.6	94.2	72.4	74.4
21.	Balance of CGB and SFs (3.+16.+17.+18.+19.+20.)	– 146.8	– 231.7	– 135.0	– 87.8	– 85.7	– 101.4
22.	Reserves of SFs for 16. and 17.	286.9	144.4	25.2	38.3	92.9	3.8
23.	Central government assets in civil servants' pension reserves and pension fund[9]	26.3					
24.	Level of general CGB reserves	48.2	7.7	4.4	10.7	6.3	0.5
25.	Balance on control account	47.7	47.7	47.7	49.2	47.7	49.2
26.	Total outstanding repayment amount including Armed Forces Fund[10]	538.0	546.4	345.2	340.7	565.6	360.5
27.	Total outstanding repayment amount from NGEU grants[e,11]	30	38	38	45	61	65

* Sources: Federal Ministry of Finance and Bundesbank calculations. Figures in Actual 2022, Target 2023 and Draft 2024 prior to the ruling of the Federal Constitutional Court in November. For methodological notes, see Deutsche Bundesbank (2016). **1** Excluding transfers to/withdrawals from reserves and including net tax revenue (for information on deductions made from revenue and expenditure, see footnote 3). **2** Excluding coin seigniorage. **3** After deduction of supplementary central government transfers, shares of energy tax revenue, compensation under the 2009 reform of motor vehicle tax and budgetary recovery assistance to federal states. **4** For 2022 according to the September 2023 figures, for 2023 according to the budget plan and the January 2024 national accounts, and for 2024 according to the 2023 spring and autumn forecasts. **5** In arithmetical terms: -€0.18 billion. However, the actual payment of €1.37 billion to the 2021 Flood Relief Fund was booked, for which the escape clause was activated. The difference was posted to the control account. **6** Based on GDP in the year before the (comprehensive) budget is prepared. **7** Budgeted figures for 2023 and 2024 from borrowing plan. **8** Entities with quarterly data, but with no figures in borrowing plan. Above all, ESF (excluding ESF-E) and pension provisions. **9** Market values according to central government balance sheet for 2022. Continuous inflows; withdrawals from the fund planned from 2030, from reserves from 2032. **10** Extrapolation of the previous year's figures with items 11 and 20; in Actual 2023, including change in the control account. In Supplementary budget target 2023, Actual 2023 and Target 2024: following removal of reserves from emergency borrowing. **11** NGEU budgeted figures and estimates, each multiplied by Germany's share of 25½% in EU gross national income.

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ment deficit (including off-budget entities) decreased very sharply, going down by €59 billion. The deficit fell mainly in the core budget.

2023: Federal Constitutional Court ruling necessitated budget revision

Revision of 2023 budget plan necessary after ruling

Central government had to revise its budget plans for 2023 on account of the Federal Constitutional Court's ruling. The budget plans had originally set aside extensive reserves from emergency borrowing for the Climate Fund, the ESF-E and the 2021 Flood Relief Fund. Central government scrapped the transfer of €60 billion, which had been deemed unconstitutional, to the reserve of the Climate Fund, and fully scrapped the reserves of the other two funds. Subsequently, it envisaged borrowing under the escape clause in the ESF-E and in the core budget for the Flood Relief Fund, replacing previously planned withdrawals from reserves. A need for adjustment was also identified in the core budget, as the calculated cyclical burden was €10 billion lower in the current projection.[12] To offset this, the supplementary budget contains, in particular, larger global spending cuts, additional withdrawals from reserves, and lower interest expenditure.

2023: core budget outturn

2023 budget outturn: more favourable than estimated in supplementary budget

The core budget closed the year with a deficit of €65 billion – an improvement of €6½ billion on the supplementary budget. Revenue exceeded the planned figure by €2½ billion (see the table on p. 69, item 2). Overall, expenditure remained €4 billion below budget estimates, particularly in the case of investments, other operating expenditure and transfers to enterprises. The target-actual deviations for individual budget items are remarkable: as central government only finalised adjustments within the supplementary budget shortly before the end of the year, more accurate estimates would actually have been expected here. Instead, the supplementary budget still contained large global spending cuts (item 1.b, ibid.).

2023 budget outturn: sharp decline in deficit compared with 2022

The deficit in the core budget fell sharply year on year, by €51 billion. Revenue rose substantially, by 6½% (+€26 billion).[13] In addition to higher tax revenue, this was due, not least, to receipts of €4 billion from the EU debt-financed Next Generation EU (NGEU) off-budget entity. Total expenditure, by contrast, decreased by a significant 5% (-€25 billion), chiefly on account of the fact that pandemic-related spending – on the statutory health insurance scheme and business aid, for example – came to an end. This outweighed the marked increase in interest expenditure (+€22 billion). Of this increase, €16 billion was attributable to discounts alone (see also the box on p. 71). Additional spending of €5½ billion on the reformed civic allowance was also a considerable factor.

2023 budget outturn: core budget complies with debt brake in arithmetical terms despite emergency borrowing; withdrawals from reserves reduced by €6½ billion

Debt brake accounting for 2023 is proving rather complicated. The plan was to exceed the net borrowing ceiling in the core budget by €1.7 billion by making payments to the Flood Relief Fund under the escape clause. On balance, however, the deficit was now €6.6 billion lower. Moreover, the net borrowing permitted under the debt brake is €1.5 billion higher because a cyclical burden that was higher by this amount was calculated.[14] On the other hand, €6.3 billion less was withdrawn from the reserves than envisaged, and coin seigniorage remained a little below estimates. On balance, therefore, the debt brake limit was slightly undershot in arithmetical terms (by just under €0.2 billion, based on mid-January data). In its debt brake accounting, however, the government counted the transfer to the 2021 Flood

12 According to the government's projection from the autumn of 2023, nominal GDP rose somewhat more strongly on account of inflation than in the autumn 2022 projection, which was the basis for the original budget plan for 2023. Factoring in the acceleration in nominal growth, central government's cyclical adjustment procedure calculated a much less unfavourable cyclical effect on the 2023 central government budget. The scope for borrowing under the debt brake decreased accordingly.

13 As per the definition in the government finance statistics, which includes gross tax revenue, revenue and expenditure in the following differ from revenue and expenditure in the table on p. 69.

14 This was due to slightly lower nominal GDP growth as calculated using the data available in mid-January.

The steep rise in central government interest expenditure

Interest expenditure decreased for a long time in the low interest rate environment, reaching a low of €3½ billion in the 2021 central government budget. It rose sharply thereafter, hitting €38 billion last year.

But this is not the result of higher borrowing costs. The ECB Governing Council did raise key interest rates by 4½ percentage points, and capital market interest rates – the rates that are relevant for central government – also rose significantly in the wake thereof. However, the resulting effective additional interest burden on central government in the 2023 financial year remained limited. Specifically, the relevant bonds newly issued in 2022 accounted for only a small part of central government debt (around €350 billion). The underlying interest rate (interest cost rate according to the 2022 borrowing report) remained relatively low, at 1.0%. Compared with the interest paid on matured debt instruments, which was very low on balance, this resulted in additional annual interest expenditure (on an accruals basis) of just under €3½ billion (of which just over €1 billion was for net borrowing from 2022).[1]

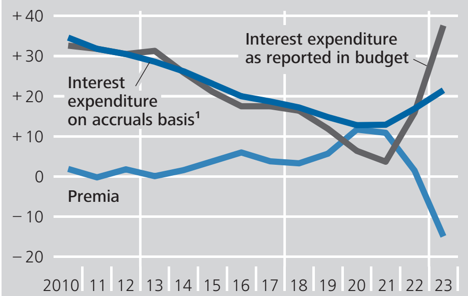
This means that there are other reasons for the decidedly steep rise in interest expenditure. A significant contribution comes from provisions for redemptions of inflation-indexed debt instruments. While the relevant payments are not made until the debt instruments mature, central government makes provisions by recording the annual inflation-driven redemption increase as interest expenditure and setting this amount aside. With inflation-indexed Federal securities worth around €70 billion, interest expenditure of €8 billion was recorded in the core budget last year, compared with just over €½ billion in 2021.

What ultimately play a decisive role are discounts on the par value of newly issued debt instruments. As central government aims for each series of debt securities to be high in volume in order to secure the accompanying interest rate advantages, it sometimes opts for tap issues for an extended period of time. Tap issues of long-dated bonds may be priced at a large discount when interest rates are on the rise. For the series with a 30-year term and a coupon of 0%, discounts sometimes amounted to around half of the bonds' par value. As the central government budget does not allocate these discounts over the bonds' term, i.e. it does not record them on an accruals basis, they place an enormous burden on interest expenditure in the year of issue. They amounted to €15 billion in 2023. Compared with 2021, a year of large premia, interest expenditure thus rose by almost €26 billion.

The Bundesbank has repeatedly proposed allocating premia and discounts on an accruals basis[2] – as in the national accounts. This would smooth out interest expenditure considerably. Fiscal policy would potentially be stabilised and the structural situation better captured. This would also make sense with regard to the debt brake: the ceiling should refer to a value that reflects the structural budget situation.

Interest expenditure and premia in central government budget

€ billion



Sources: Federal Ministry of Finance and Bundesbank estimates. **1** Approximated according to Federal Ministry of Finance's 2022 borrowing report. Besides premia, other components of interest expenditure (incl. accrued interest) are allocated on an accruals basis. Value for 2023 estimated.

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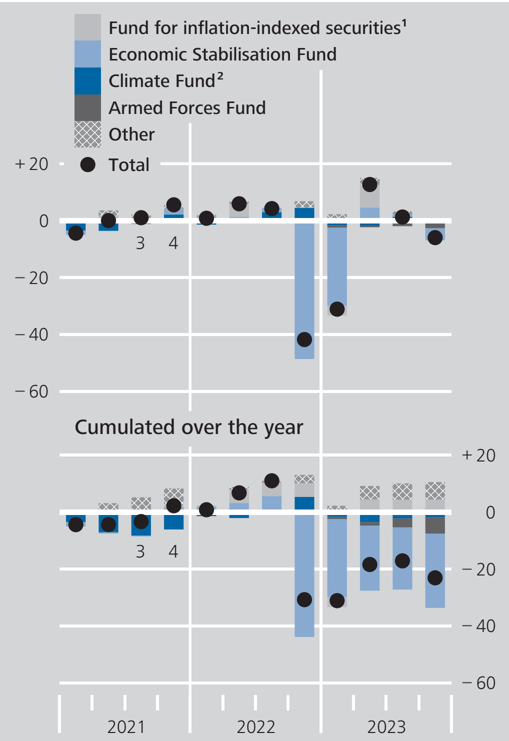
1 Refinancing from 2021 had still been easing the burden on the central government budget in the 2022 financial year.
2 See, for example, Deutsche Bundesbank (2021).

Fiscal balances of central government's off-budget entities*

€ billion, quarterly figures



Source: Bundesbank calculations based on data from the Federal Ministry of Finance. * Only entities using a single-entry accounting system, i.e. excluding, in particular, the bad bank FMS Wertmanagement and, until the end of 2022, also SoFFin, which uses a single-entry accounting system and whose deficits refinanced the bad bank's debts. **1** Precautionary fund for final payments of inflation-indexed Federal securities. **2** Climate and Transformation Fund; up to 2022, Energy and Climate Fund. **3** The transfer of €16 billion from the core budget to the Flood Relief Fund was corrected by the removal of €14 billion in reserves following the Federal Constitutional Court's ruling in late 2023. **4** Excluding the transfer of €60 billion from the core budget to the Climate Fund, which the Federal Constitutional Court deemed unconstitutional in its ruling of 15 November 2023.

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Relief Fund (Actual: just under €1.4 billion) as having been financed by means of emergency borrowing via the escape clause.[15] For this reason, the future repayment requirement for emergency borrowing also additionally increases by this amount. Adjusted for the transfer to the Flood Relief Fund recorded in this way, the outturn was then just over €1.5 billion below the ceiling, and this amount is planned to be credited to the control account.

2023: budget outturn for off-budget entities

2023 budget outturn for off-budget entities: large deficit, particularly in ESF-E; planned figures significantly undershot overall

Central government's off-budget entities[16] closed 2023 with a deficit of €23 billion (see the adjacent chart), making them a considerable €41 billion better off than envisaged back in December 2023. In 2022, the deficit stood at €31 billion.

- The ESF-E recorded a deficit of almost €42 billion – €11 billion more than in the previous year. In addition to the transfers, particularly under the electricity and gas price brakes, interest expenditure of €2½ billion was also incurred. The outturn was just over €1½ billion more favourable than envisaged in the supplementary budget. The government financed the deficit with additional emergency borrowing via the escape clause. However, the outstanding repayment burden from emergency borrowing is now considerably lower than at the end of 2022 owing to the removal of reserves from the books. Actual outflows were only one-third of the level budgeted at that time in the ESF-E's economic plan for 2023. Lower contract prices set by utility companies brought down spending on energy price brakes particularly extensively. In addition, large planned capital injections to gas trading company Uniper were not required. Supplementary energy price assistance played a negligible role, with the exception of in the hospital sector. The rest of the ESF recorded a surplus of €15 billion from repaid aid loans, following a deficit of €13 billion in 2022.

- The Climate Fund posted a deficit of €1½ billion, which was financed from the remaining reserves. This is only a moderate deterioration on the previous year if the core budget transfer of €6 billion, which was posted as revenue in 2022, is factored out.

15 See Federal Ministry of Finance (2024), pp. 26 f.
16 According to data from the Federal Ministry of Finance, i.e. excluding bad banks and other entities that use commercial double-entry bookkeeping.

Vis-à-vis the deficit of €14 billion in the economic plan, additional revenue of €2½ billion from carbon emissions certificates brought some relief. What was far more important, however, was that actual outflows were once again only just over half of the level budgeted.

– The Precautionary Fund for Redemptions (for inflation-indexed Federal securities) and the civil servants' pension fund recorded surpluses of €4½ billion and €3½ billion, respectively. The Financial Market Stabilisation Fund (SoFFin) posted a surplus of €4½ billion, mainly from loan repayments.[17]

2024 overview: central government and off-budget entities

2024: total deficit of €101 billion planned

For the current year, the plans for central government and its off-budget entities foresee a deficit of €101 billion (see the table on p. 69, item 21).[18] Of this amount, €52 billion is attributable to off-budget entities, predominantly the Climate Fund and the Armed Forces Fund. The Climate Fund is to finance its deficit from reserves, while the Armed Forces Fund is exempt from the debt brake. For the first time since 2020, central government thus plans to make no recourse to emergency borrowing via the escape clause.[19]

2024: plan for the core budget

Much larger core budget deficit than envisaged back in summer

Following the ruling of the Federal Constitutional Court, legislators made significant adjustments to the draft budget for 2024 drawn up last summer. In the core budget, the deficit now amounts to just over €49 billion. As in the summer draft budget, net borrowing is therefore at precisely the same level as the calculated upper limit of the debt brake. However, the deficit is €31 billion higher than originally planned (see the table on p. 69, item 3). This is due to several factors:

– The acquisition of additional financial assets make it possible to increase net borrowing by €16 billion (item 8, ibid.). These include a loan of €12 billion for the generational capital fund[20] and a capital injection of €4½ billion to Deutsche Bahn for the railway network.[21]

– In addition, according to the autumn projection, the cyclical component enables net borrowing to increase by just under €5½ billion (item 7).

– Since the Budget Act *(Haushaltsgesetz)* was adopted in the new year, the credit limit is based on nominal GDP in 2023. The lower GDP of 2022 (the last year prior to the Budget Act) would otherwise have been used as a basis. As a result, the ceiling is €1 billion higher (item 13).

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17 This reflected the fact that the bad bank FMSW reduced its debt to the fund and therefore ultimately decreased consolidated central government debt, too. FMSW has been refinancing itself through SoFFin for a number of years now. SoFFin's resulting deficits did not increase central government debt overall, and were thus excluded from the balance of off-budget entities. Surpluses from repayments, however, reduce central government debt and are included for this reason.
18 The deficit is expected to rise from €88 billion (Actual 2023) to €101 billion. The increase is due to the fact that entities such as, in particular, the remainder of the ESF (decoupled from the ESF-E) posted a surplus of €24 billion on balance in 2023 (see the table on p. 69, item 19), but there are no figures for these entities in the central government budget plan for 2024. Adjusted for these specific off-budget entities, there is a moderate decline in the deficit.
19 However, it was signalled that this should be reviewed in the event of a major change, especially with regard to German aid for Ukraine. In addition, a smaller group of experts (from the Federal Court of Auditors, inter alia) expressed at a hearing before the Budget Committee their opinion that in the wake of the Federal Constitutional Court ruling, the debt brake should be settled again as it was prior to the introduction of a new accounting method for special funds in early 2022. According to this accounting method, even the approved budget would already exceed the debt brake limit (see the table on p. 69, item 12).
20 See Deutsche Bundesbank (2023c).
21 The capital injection replaces investment grants from the Climate Fund and thus protects its remaining reserves. However, to date, the national accounts have not recorded such capital injections to Deutsche Bahn as financial transactions, but rather as affecting the deficit. Additional information: In the national accounts, there are plans to reassign Deutsche Bahn, in large part, to the general government sector. Instead of the capital injection, the fiscal balance of these parts of Deutsche Bahn would then play a role in the central government deficit.

– Furthermore, with an additional €9 billion, central government absorbs almost all of the remaining reserves in the core budget. Of this amount, €6½ billion stems from the better-than-planned budget outturn for 2023 (item 5).

Core budget deficit projected to decline, but mainly due to special effects

The planned deficit in the core budget is thus €15 billion lower than the Actual 2023 figure. The credit-financed loan for the generational capital fund will increase the budget deficit, but a loan of €6½ billion to the International Monetary Fund will not be paid out again. In addition, follow-on pandemic burdens from 2023 will disappear. Interest expenditure will also fall as it includes a €12 billion reduction in burdens from discounts and inflation-indexed Federal securities. Furthermore, central government will shift expenditure into off-budget entities (not least military expenditure into the Armed Forces Fund) and use the Digitalisation Fund's reserve of €4 billion in the core budget. Aside from this, it will cut its grants to the pension insurance scheme by €1 billion.

2024: plans for the off-budget entities

No net borrowing for off-budget entities under debt brake, but reserve-financed deficits persist

According to its accounting method, central government will also be in compliance with the debt brake when including its off-budget entities. Borrowing is only anticipated for the Armed Forces Fund (see the table on p. 69, item 20), which is exempt from the debt brake. The other special funds are to finance their (in some cases considerable) deficits from their reserves. This applies, in particular, to the Climate Fund (item 17.a). However, the majority of the reserves concerned could only be formed by the government because borrowing authorisations were transferred from the core budget when the escape clause was activated. From an economic perspective, there are parallels with the reserves that had to be removed from the books following the ruling of the Federal Constitutional Court. The Federal Government apparently sees no legal conflict here, though.

ESF-E dissolved; otherwise only limited changes to government plans from summer

Overall, the finalised plans for the current year yield a deficit of €52 billion for the off-budget entities.[22] Compared with the plans made back in summer, the most significant change is that the ESF-E was dissolved at the end of 2023. The energy price brakes expired at that point in time, and the core budget assumed the outstanding burdens, in particular the interest burden. As in the summer of 2023, sizeable deficits are planned for the other two large special funds.

– A deficit of €20 billion is estimated for the Armed Forces Fund. As planned back in summer, the fund is expected to cover the majority of procurement expenditure from the core budget. In addition, replacement purchases of €½ billion were estimated for materials delivered to Ukraine by the German armed forces.

– A deficit of €29 billion is estimated for the Climate Fund – only €½ billion less than envisaged in the summer of 2023. Legislators made much steeper expenditure cuts, but the estimated €9½ billion global increase in revenue envisaged in summer did not materialise. Meanwhile, the additional increase in the price of national carbon emissions certificates (€5 higher per tonne) will only generate additional revenue of €1½ billion. The court ruling directly reduced the fund's reserves by €60 billion. At year-end 2023, the government still recorded reserves of €29 billion. These are expected to be almost entirely exhausted this year. However, the medium-term plan from summer 2023 foresaw a deficit of €28 billion for 2025 as well. There is therefore still a considerable need for adjustment.

– The far smaller Digitalisation Fund is returning its remaining reserves to the core budget. It will thus post a deficit of €4 billion.

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22 Surpluses are to be expected again for the special funds for which the central government budget does not report planned fiscal balances, including, for example, the civil servants' pension fund and the COVID-19 arm of the ESF.

State government budgets[23]

2023 as a whole

Core state government budgets with a slight deficit in 2023 – considerable deterioration on 2022

The balance of state government core budgets saw a considerable deterioration of €15 billion last year. As the state governments had still posted a large surplus in 2022, however, they closed 2023 with only a slight deficit.[24]

Decline in revenue set against moderate rise in expenditure

Revenue fell by 2% (-€9 billion). Tax revenue declined by 1%. Collapsing revenue from real estate acquisition tax accruing to state governments placed a particular strain on their budgets (see p. 67). In addition, revenue from public administrations was 8% lower than in the previous year. These receipts had previously risen sharply due to central government channelling coronavirus aid through state government budgets (mainly transfers to enterprises). The corresponding state government expenditure then likewise fell. Nonetheless, total expenditure climbed by 1% (+€5 billion).[25]

Including off-budget entities, state governments may have closed 2023 broadly in balance

Including their off-budget entities, state governments may have closed 2023 broadly in balance (2022: surplus of €16 billion[26]). However, data for the year as a whole are not yet available. After three quarters, the balance for core budgets and off-budget entities combined was €19 billion less favourable than in the previous year.

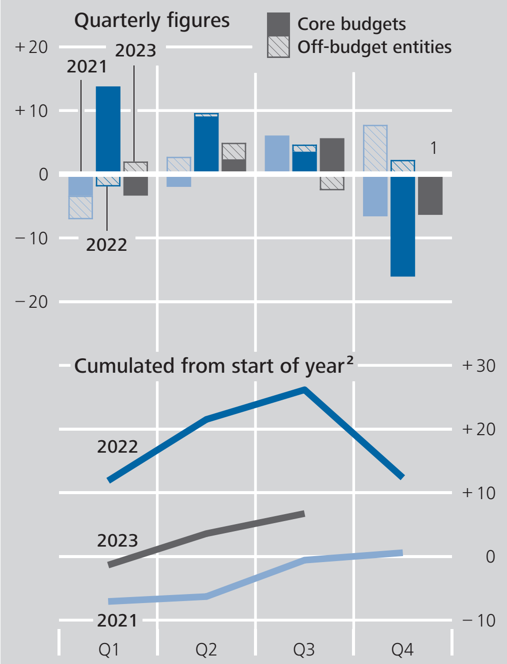
Outlook for 2024

Deficit to be expected for state governments this year

State government finances could deteriorate this year. Although state government taxes are likely to grow markedly, expenditure will probably rise more strongly than revenue. Price increases are still having a broad impact. The wage settlement of December 2023, together with comparable adjustments to civil servant salaries, entails a substantial increase in personnel expenditure. Furthermore, state governments intend to continue recruiting more staff. By comparison, transfers to local government are likely to increase more slowly – in line with the weak tax developments of the previous year, in particular.

State government fiscal balance

€ billion



Sources: Federal Statistical Office and Bundesbank calculations. **1** Figure calculated using monthly cash statistics on the core budgets from the Federal Ministry of Finance; quarterly data, which also encompass data on the off-budget entities, are not yet available. **2** Core budgets and off-budget entities together.

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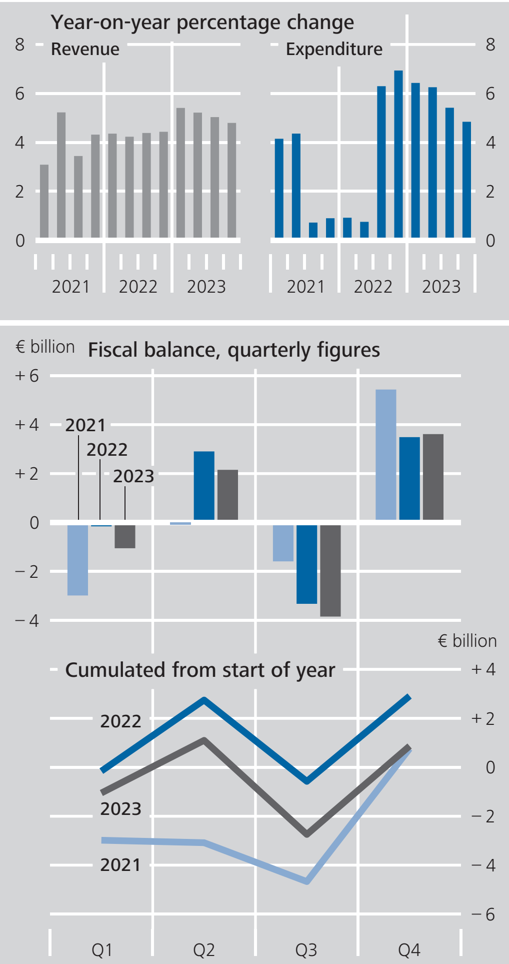
Impact of the Federal Constitutional Court's ruling on state governments

State governments have large reserves from emergency borrowing

Many state governments made use of emergency borrowing during the pandemic to build up reserves for expenditure in subsequent years. An official overview of their size is not

23 The information on the core budgets is based on the monthly cash statistics.
24 At the beginning of 2023, the monthly cash statistics showed a surplus of €14 billion for 2022 in the core budgets, whereas the cumulative quarterly data in mid-2023 only put this figure at just over €10 billion. It seems that individual state governments retroactively booked transfers to off-budget entities and thus shifted borrowing authorisations. In view of the Federal Constitutional Court's ruling in November, it appears possible that they may reverse some of these bookings.
25 In 2022, central government transferred funds of around €19 billion to state governments for coronavirus aid, which the state governments then forwarded. After adjustment for these central government transfers, state government expenditure rose by around 5%. Since the state governments had also used some of their own funds for coronavirus response measures in 2022 (which were absent in 2023), the fully adjusted rate is even higher.
26 Adjusted for missing revenue entries amounting to €3½ billion in Saarland. See Deutsche Bundesbank (2023d), p. 41.

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 quarterly figures as the latter are not revised.
Deutsche Bundesbank

available. The Bundesbank performed makeshift calculations to gauge their volume as at year-end 2022.[27] In 2023, some state governments were still planning to build up additional reserves until the Federal Constitutional Court's ruling in November. If these are taken into account, the reserves from emergency borrowing might have stood at around €30 billion at this point in time.

Federal Constitutional Court's ruling restricts reserves for state governments, too

The Federal Constitutional Court's ruling states that emergency borrowing cannot be used over multiple years. This means that state governments have to adjust their plans if they include the use of such reserves. Brandenburg, Bremen, Saarland, Saxony-Anhalt and Schleswig-Holstein, for example, all declared another state of emergency following the ruling, thus justifying the use of emergency borrowing. This mostly also applies to the current year. An alternative course of action is to release reserves financed through emergency borrowing. For instance, Mecklenburg-West Pomerania dissolved a special fund that it had previously filled with funds from emergency borrowing. Adjustments are likely to follow in other federal states, too.

Social security funds

Pension insurance scheme

2023 as a whole

Reduced surplus in 2023, further increase in reserves

The statutory pension insurance scheme recorded a surplus of €1 billion in 2023 (preliminary data). This was €2½ billion lower than in the previous year. Thanks to the surplus, the sustainability reserve was up to €45 billion at the end of 2023, leaving it at just under €40 billion above the statutory minimum.

Substantial rise in contribution receipts and pensions

Total revenue rose by 5%. At 5½%, growth in contribution receipts was somewhat stronger, even though a large volume of tax and social contribution-exempt inflation compensation bonuses were paid out to employees. Expenditure rose at a slightly higher rate (5½%) than revenue. On average across the year, pensions increased by 5%.[28] The number of pensions continued to experience only moderate growth.

Outlook for 2024

The pension insurance scheme's finances will probably remain almost unchanged this year. Expenditure is likely to rise to a similar extent as in 2023. The significant pension increase of

27 See Deutsche Bundesbank (2023d).
28 For more information on the pension increase, see Deutsche Bundesbank (2023e), p. 67.

Higher retirement age alleviates demographic burdens

The Federal Government is preparing a reform of the statutory pension insurance scheme which would see the replacement rate remain at the current level of 48% until 2039. Under existing legislation, the replacement rate is set to decline after 2025. Such a reform therefore puts additional pressure on the contribution rate to the statutory pension insurance scheme and on central government finances. The Federal Government does not intend to raise the statutory retirement age any further after 2030, at which point it will remain at 67 years. However, the planned higher pensions would be much easier to fund if the retirement age were linked to life expectancy as of 2031. If people enter retirement later, this boosts employment, economic growth and individual pension benefits calculated on the basis of income from employment. At the same time, a larger contribution base makes it easier to finance pensions, which also eases the burden on other branches of social security and the federal budget. A number of national and international bodies therefore recommend that Germany introduce such a link.[1]

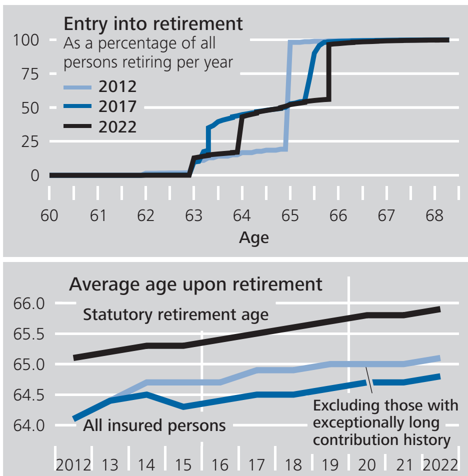
Data[2] from the statutory pension insurance scheme show how insured persons are adjusting to a higher statutory retirement age, with the actual retirement age following the statutory retirement age fairly closely[3]:

– A large proportion of insured persons enter retirement upon reaching the applicable statutory retirement age (see the upper part of the adjacent chart). The statutory retirement age was 65 in 2012 and has been gradually rising since then; in 2022 it was just under 66 years.

– The introduction of a deduction-free pension from the age of 63 for qualifying individuals led to a large reduction in the number of people retiring at the statutory retirement age. In 2012, around 80% of newly retiring old-age pensioners retired at the statutory retirement age, but by 2022 this figure had fallen to 40%.

– The deduction-free pension as of the age of 63 was introduced as a special provision for people with an exceptionally long pension contribution history of at least 45 years. It was launched in mid-2014. Initially, it was possible to draw on a deduction-free pension as of the age of 63. By 2022, the minimum age had risen to 64. The introduction of this deduction-free pension saw a surge in the proportion of people retiring early. Up to the current end,

Entry into retirement and statutory retirement age*



Sources: FDZ-RV and German statutory pension insurance scheme (Deutsche Rentenversicherung). * Persons accessing the following types of pension are not taken into account: pension for persons with reduced earning capacity, old-age pension for disabled persons (Section 37 of the Sixth Book of the Social Security Code (*Sozialgesetzbuch VI* – SGB VI), old-age pension due to unemployment (Section 237 of the Sixth Book of the Social Security Code) and old-age pension for women (Section 237a of the Sixth Book of the Social Security Code). In addition, persons entering retirement were only included if drawing on an old-age pension for the first time.

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1 The German Council of Economic Experts has called for this again recently; see German Council of Economic Experts (2023), chapter 5, pp. 21 ff.
2 See FDZ-RV – Forschungsdatenzentrum der Rentenversicherung (2012, 2017, 2022).
3 At the same time, the data do not provide any indication that insured persons are becoming more willing to accept deductions to their pensions on account of the rising retirement age, or that pensions are lower as a result. The average number of months between actual retirement and the statutory retirement age has remained broadly unchanged since 2012.

those entering retirement on this basis have made up a relatively high share of all new pensioners, at around 30%. At the same time, the age at which the bulk of early retirees enter retirement has gradually risen, mirroring the likewise increasing minimum age for a deduction-free pension (see the lines for 2017 and 2022 in the upper part of the chart, for example). It appears that a fairly small proportion of insured persons still retire as early as possible (at the age of 63) and accept pension deductions in return.

– All in all, the introduction of the deduction-free pension at the age of 63 led to an initial marked reduction in the effective average retirement age (see the lower part of the chart). Over the remainder of the period under review, too, the possibility of drawing a deduction-free pension dampened the increase in the effective average retirement age, which only increased by just over ½ year from 2012 to 2022. Excluding those with an exceptionally long contribution history, the effective average retirement age in 2022 was just over 65 years, which – much like the statutory retirement age – is one year higher than in 2012.

Other data from the German statutory pension insurance scheme show that the share of insured persons receiving a pension for reduced earning capacity prior to the statutory retirement age has not risen over the same period.[4] In this respect, the data do not reveal any impact of the significant rise in the size of the pension for reduced earnings capacity. The relatively stable share of people drawing on such a pension is consistent with studies showing that higher life expectancy, on the whole, goes hand in hand with better health at a given age.[5]

4 See German statutory pension insurance scheme (2023).
5 See Deutsche Bundesbank (2019), p. 74.

Finances largely unchanged in 2024: substantial rise in expenditure and …

mid-2023 will make itself felt until mid-2024 (nationwide average of just over 4½%). According to the 2023 pension insurance report, pensions could increase more weakly in mid-2024, by 3½%. However, the number of pensions is expected to grow somewhat more strongly than in the previous year. Furthermore, expenditure will go up due to the fact that those who entered retirement owing to a reduction in earning capacity between 2001 and 2018 are to receive a blanket rise in pensions from mid-2024 onwards (almost €1½ billion).

… revenue; central government grants cut

Contribution receipts are likely to grow substantially. Relatively high wage increases are on the cards, and tax and social contribution-exempt inflation compensation bonuses are likely to play a somewhat less significant role. Central government grants are largely tied to wage developments in 2022 and would increase by around 5% this year. However, central government is cutting these grants by just over €1 billion in order to ease the burden on its own budget.[29]

Advisable: rule-based alignment of central government grants with non-contribution-related benefits

The pension insurance scheme should be financed in a way that is transparent and readily comprehensible. It would therefore be advisable to have a rule-based system for providing central government grants that is not dependent on central government's current budgetary situation.[30] Rather, central government should name and quantify benefits that it deems not to be contribution-related. These benefits would need be financed from central government grants. Any further central government grants for the general stabilisation of the pension insurance scheme would then be easy to identify.

29 It is already a legal requirement for central government grants to be reduced by €600 million per year between 2024 and 2027. The Bundesrat has not yet approved the plan to cut them by a further €600 million per year in the same period.
30 This was also argued recently by the Social Advisory Council (2023).

Longer-term outlook

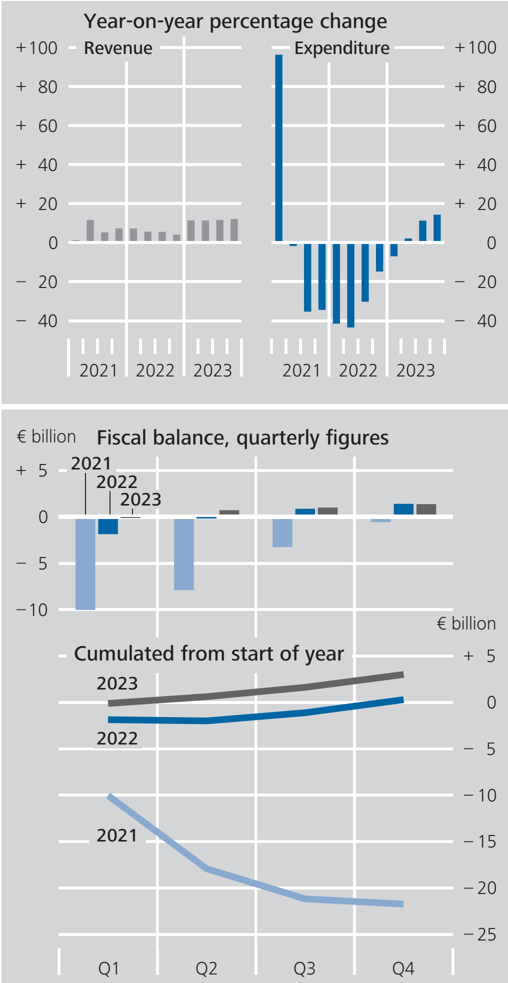
Growing demographic burdens: sharp rise in contribution rate, although replacement rate to decrease significantly after 2025

From the mid-2020s onwards, the demographic financing pressures on the pension insurance scheme will grow significantly. This was made clear, not least, by the pension insurance report published by the Federal Government at the end of 2023. According to this report, the contribution rate will jump to 19.9% in 2029 and will rise further to 21.1% by the end of the simulation in 2037. The contribution rate currently stands at 18.6%. The replacement rate is a key metric for expenditure. This will remain stable at 48% until 2025. Under current legislation, the 48% minimum threshold will expire at the end of 2025. The replacement rate will subsequently decline significantly to 45% by 2037.

Announced extension of minimum threshold for replacement rate would considerably intensify financing pressures

However, the Federal Government has announced its intention to extend the minimum threshold for the replacement rate until 2039.[31] This would significantly increase the financing pressures on the pension insurance scheme: the contribution rate would then be likely to rise by almost 2 percentage points more in the period up to 2040. The resulting increase in central government grants would place additional pressure on the central government budget. The generational capital fund also planned by the Federal Government will probably do little to change this.[32]

Finances of the Federal Employment Agency*



Source: Federal Employment Agency. * Including transfers to the civil servants' pension fund and before payment of central government grants.
Deutsche Bundesbank

Federal Employment Agency

2023 as a whole

2023: Federal Employment Agency with significant surplus due to higher contribution rate

In 2023, the Federal Employment Agency posted a surplus of €3 billion.[33] This constituted a year-on-year improvement of just over €2½ billion. This was mainly due to the fact that federal legislators had raised the contribution rate to the unemployment insurance scheme by 0.2 percentage point to 2.6% at the beginning of the year. This generated additional revenue of almost €3 billion. The core budget, which is financed by contributions, posted a surplus of €3½ billion. From this surplus, the Federal Employment Agency repaid a central government loan of €½ billion from 2022 and transferred the remainder to its free reserves, which it had used up during the coronavirus crisis. Taken together, the pay-as-you-go benefit areas of insolvency benefit and

31 See Federal Government of Germany (2023). The coalition agreement envisaged a permanent minimum threshold.
32 See Deutsche Bundesbank (2023c) for information on long-term projections and the generational capital fund.
33 In the core budget, i.e. excluding the civil servants' pension fund. Transfers to the fund lower the core budget balance. The civil servants' pension fund posted a broadly balanced budget, following a deficit of €½ billion in 2022. At the end of 2023, its funds amounted to €8 billion.

winter employment compensation posted a deficit of €½ billion in 2023. Their reserves stood at just under €3 billion at the end of the year.

Revenue up very sharply

The Federal Employment Agency's revenue rose very sharply, by 12%. Meanwhile, the pace of growth in contribution receipts was somewhat faster still, at 14%. Just under 9 percentage points of this rise was attributable to the higher contribution rate. Growth in overall revenue was dampened markedly by the fall of one-third in the insolvency benefit contribution rate, to 0.06%.

Significant expenditure growth

At +4½%, expenditure was significantly higher than in the previous year. Spending on unemployment benefits rose by 13%. Although the decline in expenditure on short-time work (-74%) largely offset this increase, outlays for active labour market policy grew by 7%. Spending on insolvency benefit rose sharply, by €½ billion, starting from a comparatively low level in the previous year. The Federal Employment Agency resumed the transfer to its civil servants' pension fund (€½ billion). These transfers had been suspended between 2020 and 2022.

Outlook for 2024

Somewhat smaller surplus planned for 2024

The Federal Employment Agency expects its finances to deteriorate somewhat this year, anticipating a surplus of €2 billion in its core budget. Its planned revenue is 5½% higher than the 2023 annual figure. On the expenditure side, outlays are expected to increase by a total of 9% compared with the previous year's figure. Spending on unemployment benefits, a major expenditure item, is projected to increase by 5½%. In addition, the Federal Employment Agency expects its expenditure on active labour market policy to be substantially higher (+20%, or +€1½ billion). Furthermore, it plans to transfer an additional €½ billion to the civil servants' pension fund.[34]

Planned surplus still plausible

As things stand, the planned surplus of the Federal Employment Agency appears plausible. The economic slowdown now seems likely to last for a somewhat longer period. As a result, labour market developments are also expected to be somewhat less favourable than was assumed in the autumn of 2023. This will put pressure on the Federal Employment Agency's finances in comparison with its plans. However, the Federal Employment Agency has traditionally tended to have quite generous expenditure appropriations for active labour market policy, which means that the planned balance should still be achievable.

34 The allocation rate rose in 2024. It increased from 96.6% to 147.7% of civil servants' pensionable remuneration.

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