Public finances*

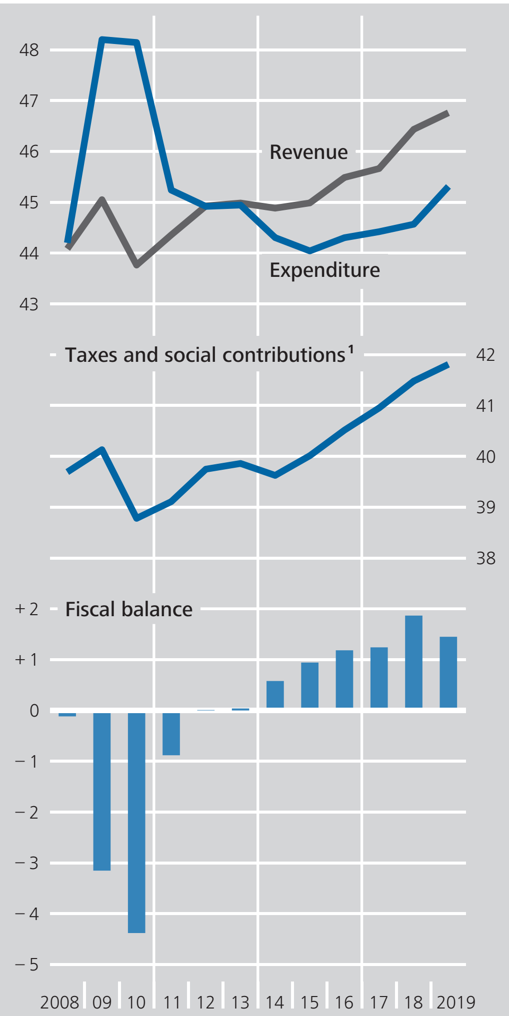
General government budget

Marked decline in surplus in 2019 due to looser spending stance

The general government surplus, which has been rising for several years now, saw a turnaround in 2019. According to provisional figures, it fell markedly to 1.5% of gross domestic product (GDP), after totalling almost 2% of GDP in 2018. The main reason for this was the government's looser spending stance. Alongside increases in social spending as well as in personnel and other operating expenditure, there was also a substantial rise in government investment. Furthermore, due to the cyclical slowdown in economic activity, tax revenue grew at a significantly slower rate than previously. Budgetary relief came from the additional reduction in interest expenditure (see also pp. 57 ff.). By the end of the third quarter of 2019, the debt ratio had fallen to 61.2% (end-2018: 61.9%).

General government fiscal ratios*

As a percentage of GDP



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

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Fiscal policy stance to remain loose in current and coming year; surplus to continue to decline

The surplus is likely to continue declining, with the result that the government budget could then be more or less balanced in 2021. The cyclical slowdown will probably again play a role here this year. However, interest expenditure is also expected to decrease further. As things currently stand, it is the further loosening of the fiscal policy stance which is driving the falling surplus. It is probable that spending will continue to rise significantly. In addition, income tax will be cut, and only part of this is offset by progressive taxation. More specifically, the income tax scale was adjusted at the start of the year and the solidarity surcharge is to be partially abolished as of 2021. Further tax cuts are on the cards. For instance, the coalition agreement intends to continue compensating for bracket creep induced by inflation in 2021 and beyond. Additional new measures, such as bringing forward the partial abolishment of the solidarity surcharge, are also under discussion. Despite considerable increases in spending by the social security funds, their contribution rates are likely to remain fairly stable overall. It will initially be possible to bridge deficits, particularly in the statutory health and pension insurance schemes, by drawing on reserves. By contrast, the climate package will probably continue to have a largely neutral ef-

* 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 annual data for 2019 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.

The structural development of the German government budget*

Results for 2019

Germany's general government budget was in surplus again in 2019. According to preliminary data, the surplus amounted to 1.5% of gross domestic product (GDP), putting it well below the previous year's figure (1.9% of GDP). The role played by cyclical influences and specific temporary effects is established using the disaggregated framework for analysing public finances. The remaining change is classified as structural. The major structural determinants are broken down separately (see the table on p. 59).

In 2019, the positive cyclical influence on the general government budget waned somewhat. Tax revenue, in particular, expanded at a slower pace, especially compared with the dynamic growth recorded in the years before. By contrast, lower spending on Landesbanken eased the strain on the general government budget. In 2018, the privatisation of HSH Nordbank resulted in one-off burdens totalling €6 billion; in 2019, Nord LB received a capital injection of just over €1½ billion. Moreover, interest expenditure declined again considerably, thanks to more favourable refinancing. These factors largely offset the less favourable cyclical influences. Overall, the structural primary balance ratio deteriorated by roughly the same amount as the unadjusted fiscal balance ratio. The primary balance does not include interest expenditure, whereas the fiscal balance does.

The deterioration in the structural primary balance ratio is mainly attributable to the looser spending stance coupled with a minimal rise in the structural revenue ratio. The main driver on the expenditure side was soaring growth in spending on pensions and healthcare, not least due to measures implemented in these areas (in particular, higher "mothers' pensions"). The structural primary expenditure ratio was also pushed up by considerable growth in intermediate consumption, compensation of employees and other investments in fixed assets.

On the revenue side, receipts from assessed income tax and wage tax showed dynamic growth, as did revenue from social contributions. However, revenue from corporation tax and local business tax fell. Yet, taxes and social contributions still rose again by a little more than can be explained by legislative changes, effects of tax progression and macroeconomic developments (positive residual; see the table on p. 59). Although various income tax cuts (especially the Family Relief Act (*Familienentlastungsgesetz*)) lowered receipts, these had only a slightly greater impact than the revenue-boosting effects of tax progression (fiscal drag).

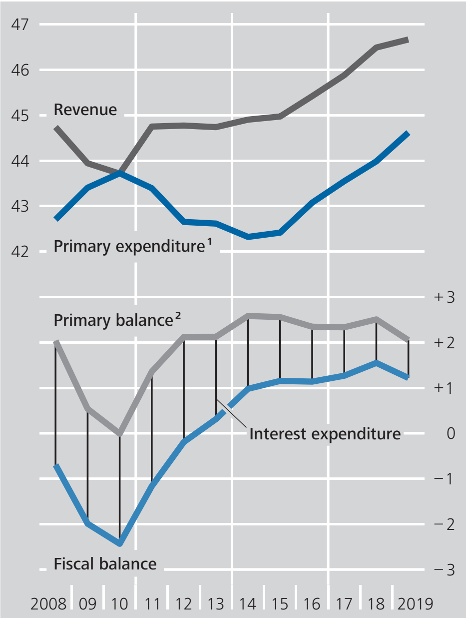
Review of the period since the 2008-09 crisis

The disaggregated framework can also be used to analyse developments since the 2008-09 financial and economic crisis. At that time, automatic stabilisers took effect and the fiscal policy stance was also loosened considerably. The former are estimated following the standard method,

* The analysis is based on national accounts data. Aside from data revisions, adjustments to the macroeconomic outlook may also result in changes. For methodological notes on the framework, see Deutsche Bundesbank (2006).

General government structural ratios*

As a percentage of nominal trend GDP



***** Based on the figures in the national accounts. The structural figures are derived by adjusting for cyclical influences and specific temporary effects. For explanations on the methodology, see Deutsche Bundesbank (2006). **1** Expenditure less interest expenditure. **2** Fiscal balance less interest expenditure.

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using the change in the cyclical component; the latter is measured here using the change in the structural primary balance ratio.

Our analysis reveals that falling interest expenditure greatly eased the strain on the general government budget. It alone was responsible in net terms for the substantial improvement in the structural fiscal balance ratio over the period from 2009 to 2019. This was primarily due to the declining average interest rate.

Before being loosened distinctly in 2019, the fiscal stance had been virtually neutral on balance since 2015. Structural primary expenditure had been rising very clearly since 2016. However, this was initially masked by strong growth in taxes and social contributions, not all of which was expected. Discretionary cuts in taxes and social contributions and the revenue-boosting effects of tax progression more or less balanced each other out. The favourable development of wages and employment had a considerable positive impact. Furthermore, profit-related taxes grew by a much greater amount than can be accounted for by the explanatory factors identified here (positive residual). This shows just how difficult it is to correctly estimate the impact of economic developments and legislative changes. It could also be an indication that measures to combat tax evasion and tax fraud have become more effective. However, it is important to be cautious about projecting the surprisingly favourable developments of the past into the future. As in the past, unexplained strong growth could be followed by times of noticeably weaker development.

Structural development of the government budget*

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

Item	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total 2009 to 2019
Unadjusted fiscal balance[1]	– 3.0	– 1.2	3.5	0.9	0.0	0.5	0.4	0.2	0.1	0.6	– 0.4	1.6
Cyclical component[1]	– 1.8	0.3	0.9	0.0	– 0.6	0.0	0.1	0.3	0.2	0.2	– 0.2	– 0.6
Temporary effects[1]	0.2	– 1.2	1.3	– 0.1	0.1	– 0.1	0.1	0.0	– 0.3	0.2	0.1	0.3
Fiscal balance	– 1.3	– 0.4	1.3	1.0	0.5	0.7	0.2	0.0	0.1	0.3	– 0.3	1.9
Interest payable	– 0.2	– 0.1	0.1	– 0.2	– 0.5	– 0.2	– 0.2	– 0.2	– 0.1	– 0.1	– 0.1	– 1.9
Primary balance	– 1.5	– 0.5	1.4	0.8	0.0	0.5	0.0	– 0.2	0.0	0.2	– 0.5	0.0
Revenue	– 0.8	– 0.2	1.0	0.0	0.0	0.2	0.1	0.4	0.4	0.6	0.1	1.8
Taxes and social contributions	– 1.0	– 0.4	0.6	0.2	0.1	0.0	0.3	0.5	0.6	0.4	0.2	1.4
Fiscal drag[2]	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	1.0
Decoupling of macro-economic reference vari-ables from GDP	– 0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.1	0.2	0.1	0.0	0.7
Legislative changes	– 0.3	– 0.6	0.3	– 0.1	– 0.2	0.0	0.0	0.0	– 0.1	– 0.1	– 0.2	– 1.3
Residual	– 0.6	0.0	0.1	0.1	0.2	– 0.1	0.2	0.3	0.4	0.3	0.2	1.0
of which: Profit-related taxes[3]	– 0.5	0.2	0.1	0.3	0.1	– 0.1	0.1	0.4	0.3	0.3	0.1	1.3
Other revenue[4]	0.2	0.2	0.4	– 0.1	– 0.1	0.2	– 0.2	– 0.1	– 0.2	0.2	0.0	0.4
Primary expenditure	0.7	0.3	– 0.3	– 0.7	0.0	– 0.3	0.1	0.7	0.5	0.4	0.6	1.9
Social payments	0.1	0.0	– 0.4	– 0.4	– 0.3	0.0	0.3	0.4	0.4	0.0	0.3	0.4
Subsidies	0.3	– 0.1	– 0.1	– 0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	– 0.1
Compensation of employees	0.1	0.1	0.0	– 0.1	– 0.1	0.0	– 0.1	0.0	0.1	0.0	0.1	0.2
Intermediate consumption	0.2	0.2	0.1	0.0	0.0	0.0	– 0.1	0.1	0.0	0.0	0.1	0.8
Gross fixed capital formation	0.1	0.0	0.0	– 0.1	– 0.1	– 0.1	0.0	0.1	0.1	0.1	0.1	0.3
Other expenditure[5]	– 0.1	0.1	0.0	0.0	0.3	– 0.2	– 0.1	0.1	– 0.1	0.2	0.1	0.2
Memo item: Expenditure on												
Pensions[6]	– 0.1	0.0	– 0.1	– 0.2	– 0.3	0.0	0.1	0.1	0.1	0.0	0.2	– 0.2
Healthcare[7]	0.2	0.1	0.0	0.0	0.2	0.2	0.0	0.1	0.1	0.0	0.1	0.9
Labour market[8]	0.1	– 0.3	– 0.3	– 0.2	– 0.1	– 0.2	– 0.1	0.0	0.0	0.0	0.0	– 1.0
Long-term care[9]	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.2	0.0	0.0	0.5

* The structural figures are derived by adjusting for cyclical influences and specific temporary effects. **1** Year-on-year change in the ratio to GDP. **2** The term "fiscal drag" encompasses the revenue effect of bracket creep in income taxation and the countervailing impact of the fact that specific excise duties are largely independent of prices. **3** Assessed income tax, corporation tax, local business tax, investment income tax. **4** Other current transfers receivable, sales and total capital revenue. **5** Other current transfers payable, other net acquisitions of non-financial assets and capital transfers payable. **6** Spending by the statutory pension insurance scheme, spending on civil servant pensions as well as payments by the Post Office Pension Fund and the Federal Railways Fund. **7** Spending by the statutory health insurance scheme and assistance towards civil servants' healthcare costs. **8** Spending by the Federal Employment Agency (excluding the reintegration payment paid to central government (from 2010 to 2013)) and central government expenditure on unemployment benefit II and on labour market reintegration measures. **9** Spending by the public long-term care insurance scheme.
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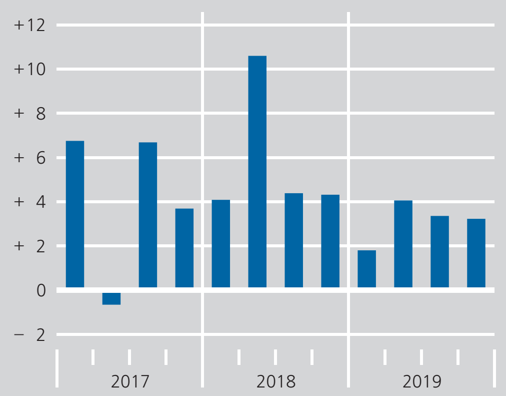
Tax revenue*

Year-on-year percentage change, quarterly figures



Source: Federal Ministry of Finance. * Including EU shares in German tax revenue but excluding receipts from local government taxes.
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fect on the balance, also after including those amendments made in December 2019.

Despite considerable growth in expenditure since 2016, fiscal leeway still exists

It is noteworthy that, assessed in structural terms, growth in government primary expenditure (expenditure excluding interest) has been much stronger than growth in nominal GDP since as early as 2016. Yet, despite this marked spending growth, the general government budget respected its ceiling by a wide margin. This is due to the fact that revenue has risen substantially and interest expenditure has fallen (see the chart on p. 58). Overall, fiscal policy on the expenditure side can hardly be described as restrained. Nevertheless, after years of very favourable economic conditions, there is still considerable fiscal leeway.

Fiscal leeway facilitates measures to foster growth and employment

This leeway facilitates measures to improve the conditions for growth and employment. At the Federal level, it would be logical to at least begin to abolish the solidarity surcharge in the current year (see also p. 64). State and local governments could make greater use of their financial leeway to improve educational opportunities or infrastructure, for instance. Funding for investment has been expanded to a considerable degree over the last few years. However, the disbursement of said funds is proving rather slow. The high levels of construction capacity utilisation are likely to have reined in investment. Swift progress is likewise often hindered by planning bottlenecks at authorities, drawn-out authorisation procedures, and reviews of legal objections. Efforts to press ahead with the expansion of required infrastructure would merit looking into these issues.

Budgetary development of central, state and local government

Tax revenue

Slower tax revenue growth in 2019

Tax revenue[1] grew by 3% in 2019, a much slower rate than that recorded in previous years (see the adjacent chart and the table on p. 61). Growth was curbed by the economic slowdown and tax cuts. Revenue was slightly higher than projected in the official tax estimate of October 2019 (+€2 billion). Assessed income tax, in particular, was up by more than forecast.

Mixed impact of economic slowdown

Developments varied very widely among the individual types of tax last year. This reflects, for one thing, the fact that the economic slowdown primarily hit the export-dependent sectors. By contrast, the domestically oriented sectors proved robust. Employment, wages and private consumption also continued to record stable development. Against this backdrop, wage tax increased considerably again (+5½%) – driven, inter alia, by additional revenue stemming from tax progression. However, the latter was partly offset by the Family Relief Act (*Familienentlastungsgesetz*) which adjusted the income tax scale in order to compensate for bracket creep from 2018. Child tax allowances and child benefits were also raised (the latter are deducted from tax revenue). Overall, the rise in profit-related taxes was negligible (+½%), but developments in this item were mixed; assessed income tax, for instance, recorded par-

1 Here, tax revenue includes EU shares in German tax revenue, but excludes receipts from local government taxes, which are not yet known for the period under review.

Tax revenue

Type of tax	Year as a whole 2018	2019			Estimate for 2019[1,2]	Q4 2018	2019		
	€ billion		Year-on-year change € billion	%	Year-on-year change %	€ billion		Year-on-year change € billion	%
Tax revenue, total[3]	713.6	735.9	+ 22.3	+ 3.1	+ 2.8	190.2	196.3	+ 6.1	+ 3.2
of which:									
Wage tax	208.2	219.7	+ 11.4	+ 5.5	+ 5.6	58.4	60.6	+ 2.2	+ 3.8
Profit-related taxes	123.9	124.4	+ 0.4	+ 0.4	− 0.9	27.6	29.0	+ 1.4	+ 5.1
Assessed income tax[4]	60.4	63.7	+ 3.3	+ 5.5	+ 3.5	15.2	16.6	+ 1.4	+ 9.0
Corporation tax	33.4	32.0	− 1.4	− 4.2	− 3.8	7.5	7.1	− 0.4	− 5.1
Non-assessed taxes on earnings	23.2	23.5	+ 0.3	+ 1.3	+ 0.2	3.7	4.0	+ 0.3	+ 6.9
Withholding tax on interest income and capital gains	6.9	5.1	− 1.7	− 25.3	− 29.2	1.1	1.3	+ 0.1	+ 13.1
Turnover taxes[5]	234.8	243.3	+ 8.5	+ 3.6	+ 3.6	60.6	62.7	+ 2.1	+ 3.5
Other consumption-related taxes[6]	92.7	93.0	+ 0.3	+ 0.3	+ 0.2	27.8	27.9	+ 0.2	+ 0.5

Sources: Federal Ministry of Finance and Bundesbank calculations. **1** According to official tax estimate of October 2019. **2** Tax revenue including (still estimated) local government taxes was €6 billion below the estimate of October 2018, which was used as the basis for the 2019 central government budget plan. According to Federal Government figures, without the legislation adopted in the meantime, the revision would have amounted to –€1½ billion. **3** Including EU shares in German tax revenue but excluding receipts from local government taxes. **4** Employee refunds deducted from revenue. **5** Turnover tax and import turnover tax. **6** 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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ticularly dynamic growth. Yet, corporate income tax, which is influenced to a greater degree by profits from exports, fell after three years of strong growth. Withholding tax on interest income and capital gains declined sharply. By contrast, non-assessed taxes on earnings were up moderately on the already high level recorded in the previous year. This item mainly comprises investment income tax on dividends. Turnover tax rose considerably (+3½%).

Underlying trend still robust, but restricted a little more by tax cuts

The official tax estimate of October 2019 forecast revenue growth of 2½% (including local government taxes) for the current year and stronger revenue growth again in the years thereafter. The slightly higher outturn for 2019 and the January 2020 revisions to central government's macroeconomic projection do not greatly alter the outlook. Growth will, however, be reined in by further tax cuts. The previous official tax estimate notably did not yet factor in the partial abolition of the solidarity surcharge as of 2021, which has now been resolved. This will reduce tax revenue by just over 1%. In addition, the coalition agreement envisages another considerable rise in child benefits and child tax allowances in 2021 and continued compensation for bracket creep. Other measures under discussion at present include lowering the solidarity surcharge as early as mid-2020 or cutting other taxes. Legal proceedings are currently underway to examine the constitutionality of the solidarity surcharge.

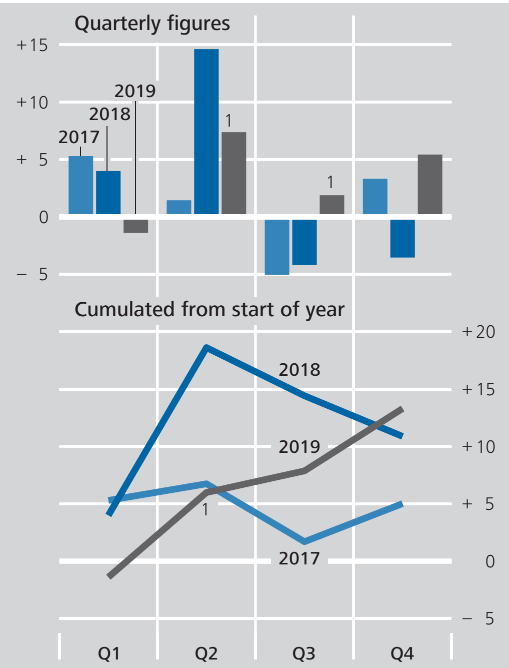
Central government budget

Surplus up in 2019 despite economic slowdown

According to provisional figures, central government posted a surplus of €13½ billion in 2019. Fuelled by a surprisingly strong final quarter, the result was €2½ billion up on the high figure recorded in the previous year. Over the year as a whole, revenue rose moderately (+2%). As a result of the economic slowdown and state governments receiving a higher share

Central government fiscal balance*

€ billion



Source: Bundesbank calculations based on data from the Federal Ministry of Finance. * Core budget excluding off-budget entities. Not adjusted for financial transactions or cyclical effects. **1** Including interest expenditure recorded ahead of time in Q2 (€7 billion).

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of turnover tax, taxes grew by only 1½% (+€6 billion). Non-tax receipts picked up by €2½ billion, primarily on account of the greatly increased heavy goods vehicle toll. At 1½%, expenditure growth was still somewhat weaker than growth in revenue. A further fall in interest expenditure (-€4½ billion) had an alleviating effect. The fact that bonds were sold even further above their nominal value (premiums) provided the most relief. These mark-ups are deducted from interest expenditure. Favourable refinancing also eased the burden on the central government budget. In addition, transfers to the digitalisation fund and the energy and climate fund (off-budget entities) fell by €3½ billion. However, almost all other spending categories recorded distinct growth.

Result again much better than planned; refugee reserve topped up significantly

The fiscal balance was up by €19 billion on the budget plan approved in autumn 2018. As in the previous years, the refugee reserve was not reduced by the budgeted amount (2019: €5½ billion). On the contrary, €13 billion was added to the reserve at budget outturn, taking its total to €48 billion.[2] The reserve was set up at the end of 2015 to ease the strain on the budget caused by the influx of refugees, which – at that time – was very strong. Evidently, the funds are not needed for this purpose. In the budget plans, they instead serve as transitional financing for additional budgetary burdens. At the end of the multi-year fiscal plans, the reserve is usually depleted and sharp reductions in expenditure are envisaged. As the latter does not appear realistic, counting on depleting high reserves poses problems. Instead, it would be worth considering setting aside the reserve to bridge unexpected budgetary burdens according to clear criteria.[3] Some state governments have also set up risk reserves to make it easier to comply with the debt brake in the event of unpleasant surprises.

Revenue much higher and expenditure much lower than forecast

Overall, revenue was €6 billion higher than forecast (excluding the planned reserve withdrawals). Taxes contributed €3½ billion to this. The rise in GDP was much slower, but the EU contributions deducted from tax revenue were €5½ billion lower, thus providing some relief overall. Additional higher-than-planned revenue came, inter alia, from EU payments and a dividend from Deutsche Bahn. Expenditure was €13 billion lower than the amount envisaged in the budget. Interest expenditure accounted for €5½ billion of this as premiums were higher than expected. In addition, current transfers (to enterprises but also to state governments, for instance for student loans, in particular) were €5 billion and other operating expenditure (for military procurements, for example) €2½ billion below budget estimates. By contrast, fixed asset formation was as planned.

Structural net borrowing, which is the key figure for the debt brake, amounts to +0.1% of GDP (see the table on p. 63).[4] The high surplus

2 For the first time, the surplus was also used to fund the reserve for multi-year military procurements – at the maximum amount of €½ billion.
3 For more information, see Deutsche Bundesbank (2018a).
4 See Federal Ministry of Finance (2020), pp. 28-29.

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

€ billion

Item	2018 Actual	2019 Budget	2019 Provisional actual	2020 Budget
1. Fiscal balance	10.9	– 5.8	13.3	– 11.0
2. Coin seigniorage	0.3	0.3	0.2	0.3
3. Transfer to (–)/withdrawal from (+) reserves	– 11.2	5.5	– 13.5	10.6
4. Net borrowing (1.+2.+3.)	–	–	–	–
5. Balance of financial transactions	0.7	0.7	0.0	– 0.3
6. Cyclical component in the budget procedure1	– 3.6	4.4	– 2.8	– 0.5
7. Balance of incorporated off-budget entities	4.0	– 3.6	0.7	– 5.9
Digitalisation fund (from 2018)	2.4	– 0.2	0.3	– 1.0
Energy and climate fund	2.9	– 0.7	1.8	– 3.8
Flood assistance fund	– 0.6	– 0.7	– 0.6	– 0.5
All-day schools (as of 2020)	.	.	.	1.0
Fund to promote municipal investment	– 0.7	– 1.9	– 0.9	– 1.6
8. Structural net borrowing (4.–5.–6.+7.) (repayment: +; borrowing: –)	6.9	– 8.7	3.5	– 5.1
9. Structural balance (8.–2.–3.)	17.8	– 14.5	16.8	– 16.1
10. Structural balance adjusted for updated estimate of potential output2	6.5	– 12.1	12.0	– 16.5
11. Debt brake ceiling (–0.35% of GDP3)	– 11.4	– 11.5	– 11.5	– 11.7

Sources: Federal Ministry of Finance and Bundesbank calculations. * For more information, see Deutsche Bundesbank, Public finances, Monthly Report, February 2016, pp. 68 f. 1 Provisional actual for 2019 according to the simplified procedure, based on the national accounts figures published in January 2020. 2 Potential output and GDP based on Federal Government's 2020 Annual Economic Report. 3 Here, this refers to GDP in the year before the budget is prepared.

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According to debt brake, surplus and high credit entry on control account despite reserve top-up

was channelled into the reserves. Net borrowing was thus recorded at €0.[5] On balance, the financial transactions to be deducted from this figure were negligible (budget estimate: +€½ billion). However, a cyclical burden of €3 billion was factored out. In the budget, a positive cyclical effect of €4½ billion had been expected. This was revised due to lower nominal GDP growth. In addition, the off-budget entities included under the debt brake recorded a surplus of €½ billion (estimate: -€3½ billion). These include the digitalisation fund, the energy and climate fund, the flood assistance fund and the fund to promote municipal investment. Structural net borrowing thus amounted to +€3½ billion (estimate: -€8½ billion) and was much more favourable than the threshold of -€11½ billion (-0.35% of GDP). Despite the transfer to reserves, the credit entry on central government's control account is set to remain high (€15 billion).[6]

Continuing relief to enable better-than-anticipated budget outturn in 2020, too

The 2020 central government budget likewise envisages no new net borrowing.[7] According to the current Federal Government Annual Economic Report, the macroeconomic outlook is not expected to deviate materially from the budget assumptions. However, the strain on the current budget is to be eased considerably by the better-than-anticipated budget outturn in 2019. It therefore again appears possible to achieve a balanced budget without the planned high withdrawal from the reserves (€10½ billion).

5 Counting the reserves towards the structural outcome masks the underlying budgetary situation and deviates from the EU rules on budgetary surveillance. Furthermore, excluding the reserve top-up, the amount credited to the control account would have been correspondingly higher. The use of control account funds is considerably more limited.
6 The entry will be booked at the beginning of March 2020 and is to be calculated using the figures for the GDP results that have been revised by then. The control account's balance already stands at €37 billion prior to this calculation.
7 For information on the budget, see Deutsche Bundesbank (2019a), pp. 62-63.

Further scope for benchmark figures for subsequent years, but still some burdens to be taken on board as well

In mid-March, the Federal Government will adopt the benchmark figures for the 2021 central government budget and for the fiscal plan up to 2024. The tax figures will be based on the 2019 outturn and the tax estimate of October 2019, which will be revised to reflect the macroeconomic assumptions contained in the Annual Economic Report. Associated changes to the tax revenue estimates in the last fiscal plan are likely to afford only limited scope. However, the refugee reserve has grown by €17 billion,[8] and some of the relief achieved during budget implementation in 2019 is likely to continue. The inflated reserve is again likely to be interpreted as extended budgetary scope. This appears to suggest that it would be logical to begin phasing out the solidarity surcharge this year.[9] There are concerns that this surcharge may be in conflict with constitutional law, and this poses considerable budget risks. As a surtax on income taxes, the solidarity surcharge can only be imposed if central government has particular financing needs. From an economic point of view, topping up and keeping a high reserve for several years suggests that such needs no longer exist. Burdens are likely to be higher than planned so far for basic pensions and the exit from coal mining and coal power. Moreover, there are plans to continue compensating for bracket creep in 2021 and beyond. This has not been included in the fiscal plan as yet. Furthermore, spending envisaged for defence and development aid falls short of the internationally agreed benchmarks. Demographic trends will place an increasing strain on the budget in the longer term. The baby boomer generation will enter retirement in the coming years. The contribution rate to the statutory pension insurance scheme is expected to rise as of 2015 and is thus anticipated to push up the central government grants connected to this rate by a considerable amount.

Central government's off-budget entities record considerable surplus again in 2019 …

According to figures from the Federal Ministry of Finance, central government's off-budget entities (excluding SoFFin, bad banks and other entities that use commercial double-entry bookkeeping)[10] recorded a surplus of €4½ billion in 2019, compared with €6 billion in 2018. The major factor behind this decline was that the surplus recorded by the digitalisation fund fell to €½ billion following the initial injection of funds in 2018 (€2½ billion). The auction of 5G frequencies in spring 2019 generated proceeds of €6½ billion; however, these payments will be staggered. The energy and climate fund's surplus fell by €1 billion to €2 billion due to a lower central government transfer and higher spending. This outweighed additional income resulting from higher prices for European CO_2 certificates. €1 billion of relief came from the fact that, in contrast to last year, there was no redemption of an inflation-linked central government security this year.

… but larger burdens planned for 2020

An off-budget entity for extending all-day childcare for children of primary school age is planned for the current year. It is to receive a transfer of €1 billion from the central government budget; expenditure is not expected until a later date. By contrast, the energy and climate fund is likely to record a deficit. The climate package adopted at the end of 2019 included a €1½ billion cut in the central government transfer. At the same time, spending on climate protection measures is set to soar. An inflation-indexed Bund is also due for redemption. This will place an additional burden of around €2 billion on the off-budget entity set up to pay for inflation-linked final payments for particular Federal securities.[11] Outflows from

8 Compared with the fiscal plan from last summer for 2021 onwards. At the end of 2019, the reserve was up by €18½ billion. However, the withdrawal from reserves included in the 2020 budget is €1½ billion higher than the amount stated in the fiscal plan.
9 It would still appear to be even more logical to completely abolish this surcharge and, if necessary, to combine this step with a fundamental tax reform. For more information, see Deutsche Bundesbank (2019b), p. 67.
10 The Federal Ministry of Finance does not publish quarterly data for off-budget entities that keep commercial accounts. SoFFin's deficit was also excluded. SoFFin has been taking out loans since 2019 and lending these funds to the government-owned bad bank "FMS Wertmanagement", which uses them to refinance legacy debt. Overall, therefore, SoFFin's deficit does not increase central government's consolidated debt level.
11 In the national accounts, this burden has already been distributed as interest expenditure to previous years on an accruals basis.

the fund to promote municipal investment and the digitalisation fund are expected to carry on picking up speed. All in all, central government's off-budget entities could close 2020 in deficit.

State government budgets[12]

Surplus high again in 2019

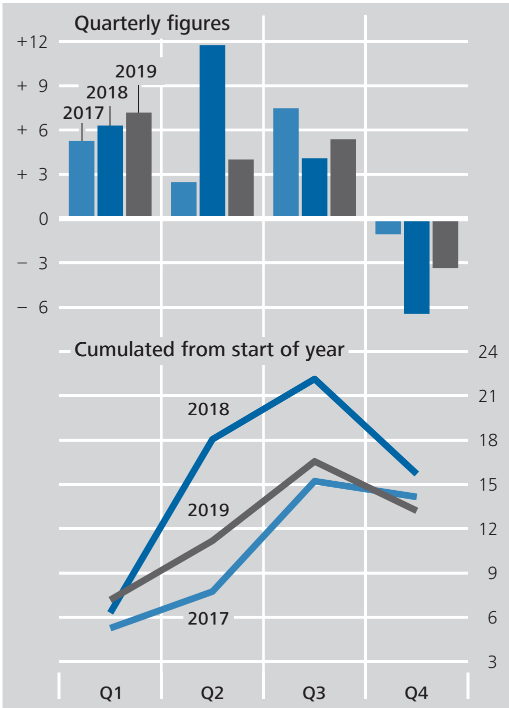
Continuing the pattern seen since 2014, state government core budgets remained in surplus overall for 2019. Preliminary figures put the amount at just over €13 billion, which was below the high figure recorded for 2018 (€15½ billion). Apart from Brandenburg, which topped up a substantial special fund,[13] all federal states posted a surplus. Revenue increased by 3% overall. Tax receipts saw dynamic growth of 4%. This was partly because state governments were left with more turnover tax funds again after the debts of the German Unity Fund were repaid in imputed terms in 2018.[14] Receipts from fines associated with diesel vehicle emissions (€1½ billion) were almost as high as they had been a year earlier. However, at just under 4%, expenditure rose at a stronger pace than revenue. Core budgets had faced a one-off exceptional burden of €5 billion in 2019 as a result of the privatisation of HSH Nordbank.[15] After adjustment for this effect, expenditure growth was as high as 5%. Personnel expenses saw a significant increase of 5%, which was largely due to pay rises for salaried employees and civil servants. A rise in staff numbers and recipients of civil servant pensions was probably also a significant factor. Current transfers to local government grew at a similar rate. Other operating expenditure, which is a much smaller spending item, recorded far stronger growth. Interest expenditure declined steeply (-10%), not least because state governments were also able to obtain much more favourable refinancing terms for their maturing securities.

Surpluses expected to continue this year and in the medium term

The outlook for state government finances remains positive both for this year and for the medium term. The official estimate of October 2019 forecasts robust tax revenue growth. As

State government fiscal balance*

€ billion

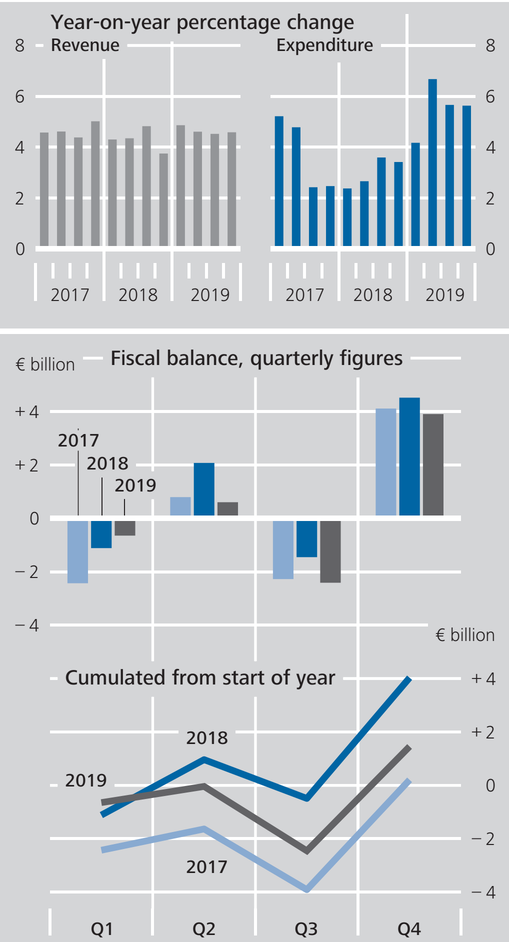


Source: Bundesbank calculations based on monthly data from the Federal Ministry of Finance. * Federal states' core budgets excluding off-budget entities.
Deutsche Bundesbank

things stand, no substantial adjustment will be needed in this regard. However, expenditure is likely to rise more sharply than revenue, causing the surplus to decline perceptibly in the medium term. In particular, spending on education and childcare will probably increase significantly. This will not only affect the large expenditure item personnel costs for teachers, as well as transfers to local government; it will also generate substantial growth in other operating expenditure and investment. By contrast, interest payments are likely to continue falling.

12 The following data are based, unless other sources are stated, on the monthly cash statistics for the core budgets.
13 In a supplementary budget, borrowing of €1 billion – possible in this way for the last time before the debt brake came into force – was planned for this purpose.
14 In actual fact, as was largely the case with the Redemption Fund for Inherited Liabilities, these debts were not definitively repaid but instead converted into central government debt.
15 The support measures for Nord LB in 2019 cost the state governments of Lower Saxony and Saxony-Anhalt just under €2 billion, though this was mostly funded outside of their core budgets.

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 revised subsequently.
Deutsche Bundesbank

Federal states well prepared for debt brake

The debt brake embedded in the German constitution came into force for state government budgets at the beginning of 2020. It requires state governments, as a general rule, to balance their budgets with no net new borrowing. Exceptions to this rule are permitted, notably, in order to offset cyclical burdens. The good overall state of their finances should permit state governments to comply with the debt brake.[16] This also applies to Bremen and Saarland, which face the highest net interest burden owing to their large debts. As a result, these two federal states are likely to benefit far more than the others from the extremely low interest rates. In addition, starting this year, they are receiving budgetary recovery assistance from central government. At €400 million each per year, this significantly exceeds the consolidation assistance they were granted previously – and, unlike the previous support, most of it may be disbursed.

Social security funds

Pension insurance scheme

Significantly reduced surplus in 2019

As a result of large expansions of benefits, the statutory pension insurance scheme saw its surplus narrow by €3 billion to €1½ billion in 2019. However, this balance was still significantly higher than originally planned (deficit of €1½ billion). The sustainability reserve rose to €40½ billion by the end of 2019, thus almost reaching 1.8 times the scheme's monthly expenditure.

Stronger expenditure growth due to higher mothers' pensions

Revenue expanded considerably, by a total of 4½%, thus mirroring the rise in per capita earnings and in employment. Expenditure growth was somewhat stronger still, at 5½%. This was due to adjustments of individual pensions averaging almost 3½% across the year, and also to a moderate increase in the number of pensions paid. In addition, legislators at central government level made further expansions to mothers' pensions. This alone contributed 1½ percentage points to expenditure growth. Furthermore, supplementary contribution rates to the statutory health insurance scheme have been financed equally by employer and employee since the beginning of 2019. Since then, the statutory pension insurance scheme has been covering the employer half of this amount for pensions.

2020: surplus probably more or less depleted

Although the reserve will probably remain significantly above the statutory upper limit of 1.5 times the scheme's monthly expenditure in

16 Furthermore, the reserves formed over the past few years will make it easier for them to cushion the impact of negative shocks. For a more detailed stocktake from autumn 2018, see Deutsche Bundesbank (2018b).

2020, it is prohibited by law to cut the contribution rate in such an event until 2025. This means that revenue will increase in parallel with employment and per capita earnings this year. However, growth is likely to weaken compared with 2019. The rise in expenditure will probably be perceptibly stronger than that in revenue. Pensions are likely to increase at a similar annual average rate as in 2019, with a somewhat stronger hike in the number of pensions. This means that the scheme's annual result will probably decline again in 2020, although it will still be broadly in balance.

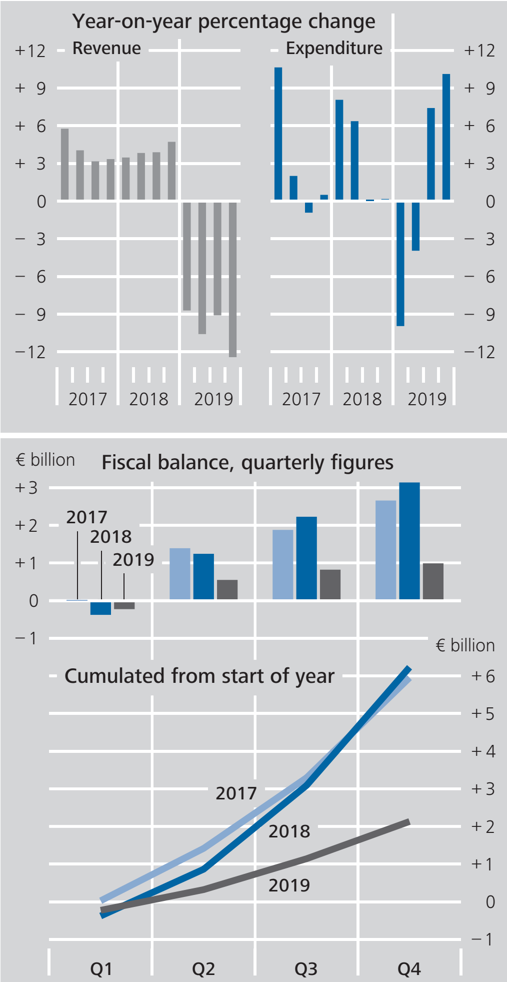
Rising deficits on the cards, with contribution rates set to increase in medium term

The financial pressure on the pension scheme is likely to increase significantly in the coming years.[17] Deficits will rise until the reserve is back down to its statutory lower limit. After that, the contribution rate will increase. The Federal Government's pension insurance report of autumn 2019 predicts a leap of 1.2 percentage points to 19.8% in 2025. The report does not expect the statutory upper limit of 20% in place until that date to be exceeded. Contrary to original expectations, there would then be no need for central government to intervene. Up to 2025, the replacement rate will remain at the minimum of 48% guaranteed until then.

Reform commission to present proposals in March

Under the current arrangements, it will not be possible to alleviate the demographic financial pressure after 2025 by raising contribution rates alone. Higher tax-financed government funds, a lower replacement rate and a rising statutory retirement age will also need to play a role. The gradual increase in the statutory retirement age will come to a halt in 2029. Yet life expectancy is likely to continue rising. The Federal Government is expecting to receive a report from the Pensions Commission in March 2020 on the reform of the statutory pension insurance scheme for the period after 2025. It would be advisable to continue to spread the growing funding burden broadly. If life expectancy keeps on rising, one approach could be to continue raising the statutory retirement age from 2030 onwards.[18]

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

Federal Employment Agency

Significantly smaller surplus in 2019

In 2019, the Federal Employment Agency posted a surplus of €2 billion for its core budget,[19] which amounted to a fall of €4 billion on the year. The 2018 surplus had been reduced by a special transfer of €2 billion to the civil servants' pension fund. However, the

17 The planned basic pension is currently under discussion in the Federal Cabinet. To broadly cover the additional expenditure, government funds are to be increased.
18 See also Deutsche Bundesbank (2019c).
19 Excluding the civil servants' pension fund. Transfers to the fund are thus recorded as expenditure, reducing the core budget balance.

actual result again significantly exceeded the estimate in the budget plan (+€½ billion). The free reserve for the core budget rose to €25½ billion (0.8% of GDP) at the end of 2019.[20]

Lower revenue due to contribution rate cut; strong growth in outlays on unemployment benefit

Revenue declined by €4 billion, or almost 10½%, on the back of the considerable contribution rate cut at the start of the year (by 0.5 percentage point to 2.5%). Developments in per capita earnings and employment remained positive. Had the contribution rate remained unchanged, the Federal Employment Agency's revenue would thus have risen by 5%. Spending on unemployment benefit saw a large increase of 9%, with per capita benefit rates rising by 4% and case numbers by 5%. Growth in the latter remained low in historical terms despite their cyclically induced rise. Outlays on advanced vocational training increased by 5½% because of an expansion of benefits at the beginning of 2019.

Moderate deficit planned for 2020, with small contribution rate cut

The Federal Employment Agency expects to record a deficit of €1½ billion in its core budget for 2020. The estimates for per capita earnings and employment in the Federal Government Annual Economic Report are somewhat more favourable than in the budget plan. This report foresees a continuation of the clearly positive developments in the contribution revenue base. At the start of the year, the contribution rate was lowered slightly by 0.1 percentage point to 2.4%. This resulted in revenue losses of around €1½ billion. On the expenditure side, growth totalling 10½% is anticipated compared with the annual result for 2019, which was not yet available when the budget was drawn up. Looking at unemployment benefit, it is expected that the number of benefit recipients will rise by 5½%, and that the per capita benefit rates will increase broadly in line with earnings. Outlays on active labour market policy and administration are also set to rise sharply. The expenditure appropriations appear generous again, albeit less so than in previous years. This remains the case even after the recent Federal Cabinet decision on short-time working benefits, as that is likely to generate only minimal additional expenditure. As things stand, then, the Federal Employment Agency's budget balance could once again be somewhat more favourable than planned, all in all, in 2020.

20 In addition, there were the insolvency benefit and winter compensation reserve (totalling €2 billion) and the reserve of €9 billion in the civil servants' pension fund.

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