Public finances*

General government budget

Fiscal policy continues to focus on coronavirus crisis

German fiscal policy is still geared towards tackling the consequences of the coronavirus pandemic. Stabilisation measures are bringing with them high deficits and rising debt. Public finances will recover as the crisis abates and fiscal stabilisation gradually comes to an end. However, the outlook here remains highly uncertain with respect to both macroeconomic developments and any potential additional stabilisation measures.

High deficit in 2020 and rising debt reflect fiscal policy support

Following a surplus of 1½% of gross domestic product (GDP) in 2019, a deficit ratio of over 5% is expected for the current year. This development is partly due to the economic slump (automatic stabilisers): this is causing taxes and social contributions from regular employment to fall whilst, at the same time, expenditure on short-time working and unemployment benefits is rising. The impact of the active fiscal policy support measures adopted since March 2020 is likely to be even greater.[1] On top of this, the fiscal stance for 2020 was already expansionary before these measures were implemented.[2] The debt ratio could well rise above 70% by the end of the year (2019: 60%). This reflects new loans to finance deficits and set up cash reserves. In addition, the debt level includes government-guaranteed loans and debt-financed capital injections for enterprises (these do not increase the deficit as defined in the national accounts). The ratio is also rising because nominal GDP is declining in the denominator.

Deficit expected to decline in 2021

The outlook for the coming year hinges crucially on macroeconomic developments and further fiscal stabilisation policy. As things currently stand, the deficit is expected to go back down, especially as stabilisation measures will come to an end over the course of the year. By contrast, a number of other decisions will push up the deficit, in particular the partial abolition of the solidarity surcharge and a significant increase in child benefits and the child tax allowance. Furthermore, the June economic stimulus package includes an additional government grant to prevent the electricity levy imposed by the Renewable Energy Act (*Erneuerbare-Energien-Gesetz* – EEG) from rising. Additional expenditure on climate measures is also planned, and only part of this will be financed by the new national carbon pricing scheme. Net payments to the regular EU budget will also weigh more heavily on balance than in the current year, with Germany's net financial contribution rising primarily as a result of Brexit. By contrast, the revenue that Germany expects from the EU's Next Generation EU (NGEU) off-budget entity will be much lower.

Escape clauses in budget rules to remain active in 2021

As the crisis will continue beyond the current year, a stabilising fiscal policy will also be important in the year to come. The escape clauses in the EU budget rules and in central government's debt brake are to remain active[3] in 2021 to make this possible. This will enable fiscal policy to support those enterprises and households that are particularly hard hit by the crisis. It might also be possible to give a more general boost to the economy. Essentially, it is a matter of effectively tackling the fallout from the crisis. Jobs and enterprises that are otherwise viable should not need to be abandoned just because

* The section entitled "General government budget" relates to data from the national accounts and the Maastricht debt ratio. This is followed by more detailed reporting on budgetary developments (government finance statistics). No data for the third quarter of 2020 are yet available for local government or the statutory health and public long-term care insurance schemes. These will be analysed in the short commentaries in upcoming issues of the Monthly Report.
1 See Deutsche Bundesbank (2020a). The excursus is based on estimates from June 2020. The strain that the crisis is placing on the budget is now expected to be much lower for 2020.
2 The Stability Council's resolution in December 2019 was based on an estimate of a ¾ percentage point decline in the structural surplus in relation to GDP to ½% of GDP in 2020.
3 Several state governments are also planning to keep their debt brake escape clauses active.

of the coronavirus pandemic. Safeguarding these underpins economic fundamentals and employment in the medium term, too.

Fiscal policy focus on stabilisation during coronavirus crisis is appropriate

Against this background, Germany's expansionary fiscal stance in 2020 and 2021 appears appropriate. Owing to the high degree of uncertainty, it is also essential to remain prepared to respond to any unforeseen developments that may arise. Germany had achieved sound public finances before the crisis and has headroom to significantly expand government stabilisation if necessary. However, new measures should be temporary in nature – as has predominantly been the case so far. Structural burdens would be critical insofar as fiscal challenges – for instance, tax losses expected in the medium run (see pp. 65 f.) and demographic change – will become tougher to overcome in the medium term. Once the crisis abates and the normal budgetary rules apply again, it is important that public finances be restored to a sound footing within a reasonable period of time. This will ultimately be the prerequisite for maintaining confidence in the public finances of both Germany and the other euro area Member States alike.

Budgetary development of central, state and local government

Tax revenue

Tax revenue down in Q3: support measures play significant role

Tax revenue[4] in the third quarter of 2020 was considerably lower than in the same period last year (-6%; see the chart and table on p. 64). This was the result, not least, of measures from the June economic stimulus package. The weak economic situation also led to further shortfalls, though these were on a much smaller scale than the shortfalls following the massive slump in the second quarter. Wage tax fell by 11½%. Revenue from wage tax was reduced significantly by short-time working[5] and the first tranche of the bonus child benefit payment, which, like child benefits, is deducted from this type of revenue. Without this bonus payment, wage tax would have fallen by only 4½%. Profit-related taxes were down by a total of 4½%. Corporation tax was again particularly affected; however, revenue from this item declined by less than in the second quarter. The same was true for assessed income tax. By contrast, there was a significant rise in non-assessed taxes on earnings – chiefly investment income tax on dividends. This was probably attributable in part to the fact that some shareholders' meetings took place later on, thus shifting dividend payouts into the second half of the year. VAT decreased by 2%. Both dwindling private consumption and support measures had a part to play here. Specifically, the temporary cut in VAT, which came into force at the beginning of July, led to significant revenue shortfalls. However, VAT revenue was only partly affected in the third quarter as VAT is paid with a lag of up to two months. The cut in VAT was counteracted by deferrals from the previous quarter tailing off, with general government ultimately receiving more in payments than it granted in new deferrals.

Tax revenue set to decline by 9% for 2020 as a whole

According to the current projection issued by the Working Party on Tax Revenue Estimates, tax revenue for 2020 as a whole will be 9% lower than in the previous year. The major factor driving this development is a decrease in key macroeconomic reference variables. As average wages are also in decline, progressive taxation will push revenue down further. In addition, support measures related to the coronavirus pandemic are stifling revenue considerably. Notable measures include the VAT cut applicable throughout the second half of 2020 as well as the bonus child benefit payment for parents. Enterprises are receiving sup-

4 Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the quarter under review.
5 Short-time working reduces wages, and short-time working benefits are not taxed. For the purposes of income tax assessment, however, short-time working benefits are factored in when the tax rate is determined *(Progressionsvorbehalt)*. This leads to higher tax rates, which in turn leads to a moderate increase in tax revenue in the following year.

Tax revenue

Type of tax	Q1-Q3 2019 € billion	Q1-Q3 2020 € billion	Q1-Q3 Year-on-year change € billion	Q1-Q3 Year-on-year change %	Estimate for 2020[1] Year-on-year change %	Q3 2019 € billion	Q3 2020 € billion	Q3 Year-on-year change € billion	Q3 Year-on-year change %
Tax revenue, total[2]	539.6	496.0	– 43.6	– 8.1	– 8.5	179.0	168.3	– 10.7	– 6.0
of which:									
Wage tax	159.0	151.6	– 7.4	– 4.7	– 5.1	53.7	47.5	– 6.2	– 11.5
Profit-related taxes	95.4	80.1	– 15.3	– 16.0	– 15.1	27.6	26.3	– 1.3	– 4.7
Assessed income tax[3]	47.1	42.8	– 4.3	– 9.1	– 8.9	13.6	13.5	– 0.1	– 0.9
Corporation tax	24.9	16.3	– 8.6	– 34.7	– 34.1	7.6	5.4	– 2.2	– 28.9
Non-assessed taxes on earnings	19.5	15.9	– 3.6	– 18.5	– 15.1	5.2	5.9	+ 0.7	+ 13.8
Withholding tax on interest income and capital gains	3.9	5.1	+ 1.3	+ 32.6	+ 25.3	1.2	1.5	+ 0.3	+ 25.3
VAT[4]	180.6	164.1	– 16.4	– 9.1	– 10.1	61.1	59.8	– 1.2	– 2.0
Other consumption-related taxes[5]	65.0	62.7	– 2.3	– 3.5	– 3.8	22.8	22.4	– 0.4	– 1.8

Sources: Federal Ministry of Finance, Working Party on Tax Revenue Estimates and Bundesbank calculations. **1** According to official tax estimate of November 2020. **2** Including EU shares in German tax revenue, including customs duties, but excluding receipts from local government taxes. **3** Employee refunds deducted from revenue. **4** VAT and import VAT. **5** 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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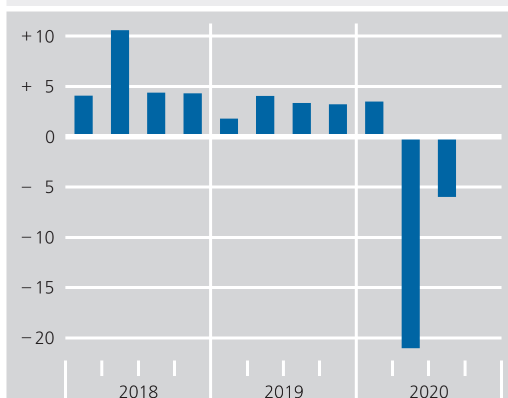
port in the form of liquidity assistance: for example, their excessively high tax prepayments can be quickly adjusted and they can have their tax payments temporarily deferred.

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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Significant increase in 2021 and somewhat slower tax growth thereafter

Tax revenue is expected to grow significantly in 2021 (+6½%), primarily on account of the assumed macroeconomic catch-up process. Progressive taxation should then go back to boosting revenue, as usual. As some COVID-19 measures will expire, the working group also expects incoming payments of taxes. However, tax revenue will come under strain from rising shortfalls resulting from other support measures (e.g. introducing the option of depreciation using the declining-balance method) and the partial abolition of the solidarity surcharge. In the years thereafter, i.e. from 2022 to 2025, revenue is projected to rise between 5% and 3½% annually, largely reflecting the assumptions made regarding macroeconomic developments and progressive taxation.

Further cuts in income tax and increase in child benefits not yet included

The working party only takes account of the tax legislation applicable when it draws up a tax estimate. As a consequence, one notable piece of legislation that its calculations do not factor in is the Second Family Relief Act *(Zwei-*

Official tax estimate figures and the Federal Government's macroeconomic projection

Item	2020	2021	2022	2023	2024	2025
Tax revenue[1]						
€ billion	728.3	776.2	816.0	847.3	879.0	908.4
As % of GDP	22.0	22.1	22.3	22.5	22.8	23.0
Year-on-year change (%)	– 8.9	6.6	5.1	3.8	3.7	3.3
Revision of previous estimate (€ billion)	10.6	3.4	5.4	0.6	– 4.2	.
Real GDP growth (%)						
Autumn projection (October 2020)	– 5.5	4.4	2.5	1.0	1.0	1.0
Interim projection (September 2020)	– 5.8	4.4	1.5	1.5	1.5	.
Autumn projection (October 2019)	1.0	1.3	1.1	1.1	1.1	.
Nominal GDP growth (%)						
Autumn projection (October 2020)	– 3.8	6.0	4.3	2.6	2.6	2.6
Interim projection (September 2020)	– 4.0	6.0	3.0	3.0	3.0	.
Autumn projection (October 2019)	2.9	3.1	2.8	2.8	2.8	.

Sources: Working Party on Tax Revenue Estimates (November 2020) and Federal Ministry for Economic Affairs and Energy. **1** Including EU shares in German tax revenue, including customs duties, including receipts from local government taxes.
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tes Familienentlastungsgesetz) that has already been adopted by the Bundestag. This legislation provides for a rise in the basic tax allowance for 2021 and 2022, and shifts the other income tax brackets to the right. Furthermore, child benefits and the child tax allowance are to be raised significantly again in 2021.

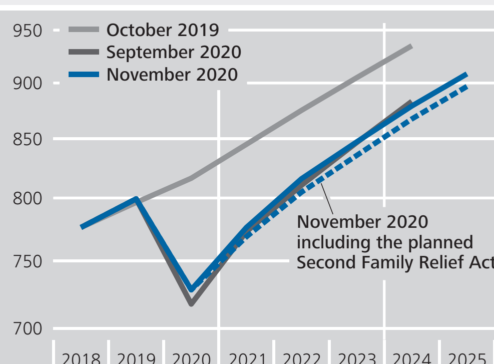
Compared with September estimate, additional revenue from 2020 to 2022 and revenue shortfalls in 2024

Owing to the very high degree of uncertainty in the coronavirus crisis, the working group also updated its estimate in September – outside the standard cycle for preparing estimates. According to the latest tax estimate, additional revenue of €10½ billion is expected this year compared with the September figure (see also the table above). The new macroeconomic assumptions for key reference variables for tax revenue are somewhat less favourable for 2020. However, the cash balances were a positive surprise, especially in the case of profit-related taxes. Additionally, fewer burdens arising from court rulings on real estate transfer tax are now expected.[6] The estimates for 2021 and 2022 are €3½ billion and €5½ billion higher. This is mainly due to more favourable macroeconomic assumptions. In addition, the working group now assumes a somewhat slower catch-up process for some profit-related taxes. This and the fact that the beneficial one-off effect of the revised court ruling will no longer be felt reduce the positive base effect from the previous year. From 2023 onwards, however, overall economic growth is less favourable in the new estimate. This is the main reason why tax revenue is expected to be moderately lower than in the September estimate.

Compared with the last pre-COVID-19 estimate (autumn 2019), this year's expected tax receipts are down by €88 billion (2½% of GDP). Whilst annual revenue shortfalls are expected to wane

Tax estimates: revisions made in the wake of the coronavirus pandemic*

€ billion, log scale



Sources: Working Party on Tax Revenue Estimates, Federal Ministry of Finance and Bundesbank calculations. * General government tax revenue according to the official tax estimates.
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6 Implementation of the Federal Fiscal Court's rulings on tax exemption pursuant to Section 6a of the Real Estate Transfer Tax Act *(Grunderwerbsteuergesetz)*; see also Federal Ministry of Finance (2020).

Compared with pre-COVID-19 estimate, revenue expected to be markedly lower in medium term, too

in subsequent years, there is still set to be a shortfall of over €50 billion at what was the end of the projection period in 2024 compared with the autumn 2019 estimate. These drops in revenue are mainly due to the fact that economic activity will be unable to match the macroeconomic expectations from prior to the coronavirus pandemic. Furthermore, legislative changes, such as the partial abolition of the solidarity surcharge, will play a significant role.

Central government budget

Deficit high again in Q3 due to pandemic

Central government recorded a high deficit of €21½ billion in the third quarter of 2020, compared with a surplus of €2 billion in the same quarter of 2019. Revenue fell by 10% due to a €9½ billion drop in tax revenue. Expenditure rose steeply, by 15½% (€14 billion). Transfers to state governments increased by €5½ billion, driven to a large extent by compensation payments for losses suffered by public transport companies due to the COVID-19 outbreak and for unoccupied hospital beds. Payments to the social security funds, in particular, increased by even more (+€6½ billion). For example, the health fund alone received €3½ billion on a one-off basis to compensate for exceptional burdens stemming from the pandemic. Crisis assistance for enterprises played only a minor role. Expenditure on the basic allowance for job seekers continued to increase only moderately (by just under €½ billion). In terms of investment expenditure, loans to the social security funds rose by €4 billion. Payments to the Federal Employment Agency for the purpose of offsetting the deficit are recorded under this item. By contrast, interest expenditure continued to decline significantly (-€3 billion). This was mainly due to the once again higher premiums received in the sale of central government debt instruments.

Record deficit this year, but probably considerably lower than budgeted

After three quarters, the deficit in the central government budget came to €63½ billion. In the second supplementary budget, a record deficit of €218 billion is forecast for the year as a whole. There are indications that high burdens are yet to come. Planned transfers to special funds of around €30 billion are of particular importance. The one-off reimbursement of local governments' local business tax losses, accounting for €6 billion, will likewise leave a mark. Additional loans to the Federal Employment Agency could be of a similar size. Further burdens include capital injections to Deutsche Bahn (€5 billion) and the permanent increase in central government's share of the accommodation costs for recipients of unemployment benefit II (€3½ billion). On top of this, bridging aid for enterprises hit by the pandemic was extended and massively expanded to help them through the restrictions recently imposed. Nevertheless, the expenditure framework of around €25 billion available for this purpose still seems sufficient. All in all, so far it seems that net borrowing will remain well below the estimated amount. A deficit of around €150 billion seems plausible. If net borrowing stays lower than planned, the future repayment amount required under the debt brake will also be lower. To date, the repayment figure has been estimated at €6 billion per year for 2023 to 2042. This amount could be roughly halved.

Supplement aid for enterprises by expanding tax loss carrybacks

So far, there has been limited take-up of bridging aid for enterprises, even though sales in some sectors have fallen sharply. Widening the options for tax loss carrybacks seems an apt way to expand targeted aid: more years could be factored in, the ceilings could be raised further and local business tax could also be included. This would enable enterprises that were profitable before the crisis to receive prompt assistance and effective support.

Draft budget for 2021 includes renewed activation of escape clause

Central government adopted the draft budget for 2021 at the end of September. Given the high degree of uncertainty due to the coronavirus pandemic, this was later than usual. Central government envisages activating the debt brake escape clause again. Net borrowing is expected to amount to €96 billion. As in the second supplementary budget for 2020, there are no plans to use reserves. This alone increases

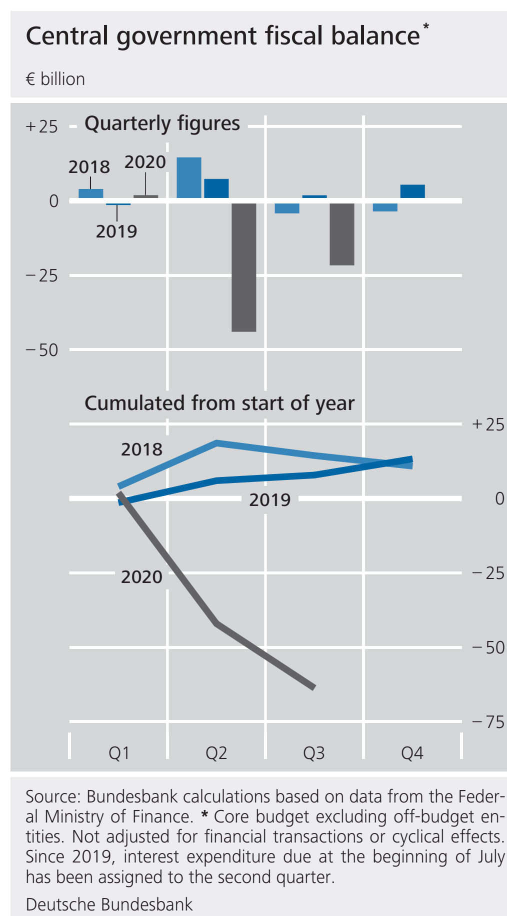
the funds required by €19½ billion compared with the March benchmark figures, which did not factor in the fallout from the coronavirus (and net borrowing). Compared with the March figures, tax revenue is estimated to be €32 billion lower, also owing to measures taken in response to the pandemic. In addition, global revenue shortfalls of €4 billion are factored in. These are presumably intended to cover pledged tax transfers to state governments in order to shield them from the consequences of the VAT cut. Moreover, expenditure appropriations were raised substantially. For instance, the social security funds are set to receive €11 billion in connection with the pandemic. The main aim of this is to keep the overall contribution rate below 40%. Taken together, the figures budgeted for long-term unemployment benefits and for claims from guarantees were raised by a similar amount. Additional funds have been earmarked to extend bridging aid. There are also higher grants for climate measures, amongst other things.

Repayment plan for escape clause debt implies annual burdens of €5 billion as of 2026

The Bundestag will deliberate on the 2021 central government budget until December. According to the draft budget, the standard limit for net borrowing will be exceeded by €86 billion (see the table on p. 68). Structural net new borrowing of €12 billion is permitted under the debt brake. In addition, borrowing is permitted for cyclical burdens and the acquisition of financial assets, estimated at €14 billion and €2 billion, respectively. However, the figures also have to take account of the large deficit for the off-budget entities incorporated under the debt brake, which is projected to be €18 billion (€14 billion for the Energy and Climate Fund). Repayment of the exceptional debt is scheduled to start in 2026 and end in 2042. This corresponds to €5 billion per year.

Count EU borrowing for transfers towards debt brake

This does not take into account borrowing planned by the European Union (EU) for transfers. Central government will also bear the costs for this in line with Germany's share of funding for the EU budget. Repayment is scheduled to start in the second half of the decade, and funds to be provided by Germany are expected to be correspondingly higher. The basic idea behind the debt brake would suggest that this EU debt should be taken into account in line with Germany's share of funding. Just like any borrowing by central government itself, this is expected to place a strain on the central government budget in the future.



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. Since 2019, interest expenditure due at the beginning of July has been assigned to the second quarter.
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Fiscal plan up to 2024: full depletion of reserves and substantial unspecified need for action

In the medium-term fiscal plan, there are still large tax shortfalls compared with the March benchmark figures. Although tax revenue will regain some lost ground over time, the gap still amounts to €20 billion in 2024, the final year covered by the plan. In addition, part of the additional expenditure from the June economic stimulus package is set to stretch into the longer term. Central government's higher share (around €3½ billion) of accommodation costs for recipients of the basic allowance will have a sustained negative impact on the central government budget. As a result of these factors, the financial situation is likely to remain strained

Central government's fiscal planning up to 2024 and the result for the debt brake*

€ billion

Item	Actual 2019	Second supplementary budget 2020	Draft 2021	Fiscal plan 2022	2023	2024
1. Expenditure[1]	343.2	508.5	413.4	387.0	387.1	393.3
of which:						
1.a Investment	38.1	71.3	55.2	48.0	48.0	48.0
1.b Global spending increases/cuts	–	– 2.3	– 3.3	– 9.8	– 14.6	– 15.6
2. Revenue[1,2]	356.5	290.4	317.0	347.7	366.8	380.9
of which:						
2.a Tax revenue[1]	329.0	264.4	292.0	308.4	325.2	338.5
2.b Global revenue increases/shortfalls	–	–	– 4.0	10.1	12.5	12.8
3. Fiscal balance (2.–1.)	13.3	– 218.1	– 96.5	– 39.3	– 20.3	– 12.4
4. Coin seigniorage	0.2	0.3	0.3	0.3	0.3	0.3
5. Transfer to (–)/withdrawal from (+) reserves	– 13.5	–	–	28.5	13.3	6.9
6. Net borrowing (–)/repayment (+) (3.+4.+5.)	–	– 217.8	– 96.2	– 10.5	– 6.7	– 5.2
7. Cyclical component in the budget procedure	– 2.7	– 53.6	– 14.0	– 10.2	– 5.5	0.0
8. Balance of financial transactions	0.0	– 14.6	– 2.1	– 2.0	– 1.1	– 0.5
9. Balance of incorporated off-budget entities (estimated as of 2022)[3]	0.7	19.1	– 18.1	– 13.3	– 6.2	– 2.1
9.a Energy and Climate Fund	1.8	20.4	– 14.1	– 10.2	– 4.3	– 1.5
9.b Flood Assistance Fund	– 0.6	– 0.7	– 0.3	.	.	.
9.c Fund to Promote Municipal Investment	– 0.9	– 1.3	– 1.6	.	.	.
9.d Digitalisation Fund	0.3	– 1.0	– 1.8	.	.	.
9.e Fund for Primary School-Age Childcare Provision	–	1.8	– 0.3	.	.	.
10. Structural net borrowing (–)/repayment (+) (6.–7.–8.+9.)	3.3	– 130.4	– 98.2	– 11.6	– 6.3	– 6.7
11. Amount exceeding ceiling[4] (16.+13.–10.)	–	118.7	86.2	–	–	–
12. Outstanding repayment amount, escape clause	–	118.7	204.9	204.9	199.0	193.0
13. Repayment amount due	–	–	–	–	5.9	5.9
Memo items:						
14. Need for action according to 2021 financial report	–	–	–	9.9	16.4	16.2
15. Relief from global spending cuts and global revenue increases as well as withdrawal from reserves (2.b–1.b+5.)	–	–	–	48.4	40.4	35.3
16. Regular ceiling: structural net borrowing of 0.35% of GDP[5]	– 11.5	– 11.7	– 12.1	– 11.6	– 12.3	– 12.6
17. Structural fiscal balance (3.–7.–8.+9.)	16.7	– 130.8	– 98.5	– 40.4	– 19.9	– 13.9
17.a Structural fiscal balance with estimate of potential output according to fiscal plan	1.8	– 149.0	– 98.5	– 40.4	– 19.9	– 13.9
18. Amount credited to control account	14.8	–	–	–	–	–
19. Credit balance on control account	52.0	52.0	52.0	52.0	52.0	52.0

* For methodological notes, see Deutsche Bundesbank (2016). **1** After deduction of supplementary central government grants, shares of energy tax revenue, compensation under the 2009 reform of motor vehicle tax and consolidation/budgetary recovery assistance to federal states, excluding transfers to/withdrawals from reserves. **2** Excluding coin seigniorage. **3** Estimated amount makes full use of the scope remaining under the debt brake. **4** Repayment plan for the amount from (a) 2020: 1/20 per year from 2023 to 2042; (b) 2021: 1/17 per year from 2026 to 2042. **5** Here, this refers to gross domestic product in the year before the budget is prepared.

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beyond 2021. However, the debt brake escape clause is set to be deactivated after the expected easing of the coronavirus pandemic. The central government fiscal plan thus envisages compliance with the standard limit for structural net borrowing from 2022 onwards. It appears that central government will make full use of the net borrowing permitted within this framework. To close funding gaps, the fiscal plan envisages depleting the reserves of €48 billion, with €7 billion of this still being drawn in 2024, the final year of the plan. Furthermore, the plan identifies a required level of action that rises from €10 billion in 2022 to just over €16 billion in the two subsequent years. Alongside global spending cuts of almost the same amount, the plan envisages global revenue increases, for which measures are to be specified at a later date. Measured by these global items, the need for action on the expenditure and revenue sides is higher than the aforementioned figure, rising from €20 billion in 2022 to €28 billion in the final year of the plan.

Report required level of action transparently in future; not yet necessary to pass consolidation measures

At present, however, it is still difficult to predict what level of action will actually be required. This will hinge, not least, on the course of the COVID-19 crisis and on the economic recovery. Nonetheless, the required level of action projected as things currently stand should be fully and transparently reported in order to provide a clear picture of the expected challenges. Given the very high level of uncertainty, though, it would seem appropriate to refrain from discussing specific consolidation measures for now. Instead, the focus should be on managing the coronavirus crisis, including measures to support the economic recovery. However, any additional measures should be time-limited in order to avoid putting public finances under even more pressure after the crisis has come to an end.

Very high COVID-19 costs for central government's off-budget entities in Q3, …

Central government's off-budget entities recorded a deficit of €29 billion in the third quarter of 2020, compared with a surplus of €2 billion in the same period last year.[7] The key driver of this development was coronavirus assistance provided by the Economic Stabilisation Fund. Its deficit of €29 billion stemmed primarily from funding coronavirus aid loans issued by the Kreditanstalt für Wiederaufbau (KfW). Acquisitions of equity, particularly in Lufthansa, accounted for €1½ billion.

… strong countereffect until end of year from prefunding of Energy and Climate Fund

In the final quarter of the year, further business aid could have a negative impact on the Economic Stabilisation Fund's finances. However, borrowing will probably remain far below the authorisation of €200 billion. Furthermore, surpluses are arising in areas where central government is prefunding future expenditure, e.g. the new fund for financing additional after-school care places for primary school children (just under €2 billion). Due to planned central government payments, the surplus of the Energy and Climate Fund is expected to be as high as €20½ billion.

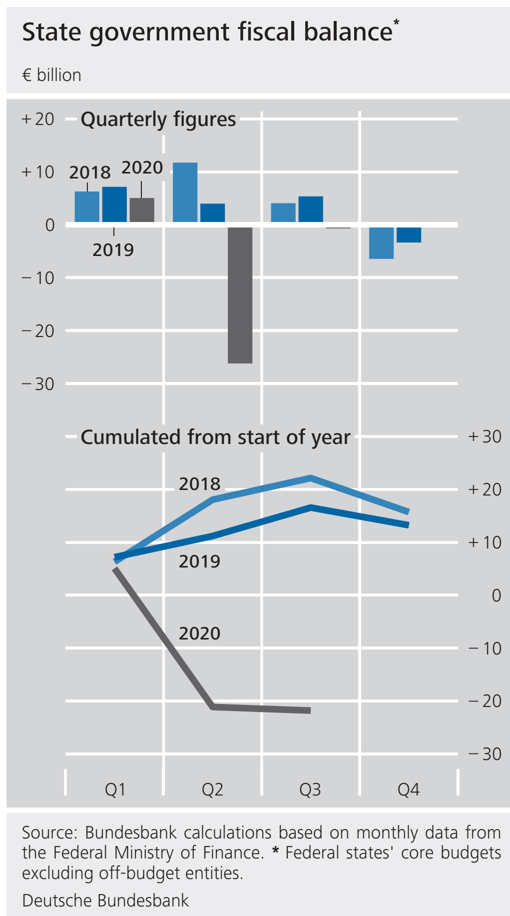
Large deficit next year, not least for Energy and Climate Fund

Next year, central government's off-budget entities are likely to record a large deficit. The extent to which assistance is paid out by the Economic Stabilisation Fund will depend, not least, on how the pandemic progresses, and thus cannot be reliably estimated. The Energy and Climate Fund appears certain to record high outflows, due primarily to the stabilisation of the EEG levy, which is estimated at €11 billion. By contrast, spending on climate measures is to be funded mainly through the new pricing scheme for carbon emissions from transport and building heating.

State government budgets[8]

The COVID-19 crisis continued to place a strain on state government core budgets in the third

7 According to data from the Federal Ministry of Finance, i.e. excluding bad banks and other entities that use commercial double-entry bookkeeping. The Special Fund for the Stabilisation of the Financial Market (SoFFin) is also omitted. SoFFin channels refinancing funds to the bad bank FMSW. In return, the direct debt of FMSW, which is attributable to central government, is partly repaid.
8 The data on the state government core budgets are based on the monthly cash statistics. Results for the off-budget entities are not yet available for the quarter under review.



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

Core budgets record slight deficit in Q3

quarter of 2020. They posted a slight deficit of €½ billion, compared with a surplus of €5½ billion a year earlier. However, this figure provides only limited insight into the overall situation; many state governments set up off-budget entities, which paint a picture of the pandemic's financial impact. At the current end, it is almost impossible to keep track of the financial relationships between these off-budget entities and the corresponding core budgets.[9] In general, such links inflate the revenue and expenditure of the core budgets. No specific data on this are yet available.

Coronavirus aid payments significantly boosted revenue and expenditure

Revenue grew steeply in the third quarter, by 9½% (+€9½ billion). Tax revenue proved to be comparatively stable (+½%), after falling substantially in the previous quarter. There was a very large increase (of 29%, or €6 billion) in revenue received from public administrations, not least from central government. At a total of 16½% (+€15½ billion), the rise in expenditure was much faster than that in revenue. Growth in payments to public administrations was particularly strong, at 19% (+€5½ billion). By contrast, transfers to local government played only a minor role.

Very large deficit foreseeable for year as a whole

In the final figures for last year, core budgets recorded a surplus of €10 billion and off-budget entities a surplus of €6½ billion; some off-budget entities were topped up before the state government debt brakes fully entered into force in 2020.[10] According to the current projection issued by the Federal Ministry of Finance for the Stability Council, the state government core budgets could close this year with a deficit of €40 billion. After three quarters, the deficit in the core budgets now stands at just under €22 billion. In particular, compensation of local governments for shortfalls in local business tax this year will be paid out in the final quarter. State governments will contribute €5 billion to this compensation. The coronavirus crisis is likely to place a large burden on state government finances for the year as a whole.

Pandemic will continue to put pressure on state governments in 2021

The COVID-19 crisis will continue to place a large strain on state government budgets in 2021. It therefore seems likely that the debt brake escape clauses will be activated again. According to the latest estimate, tax receipts will be €20 billion lower than was expected before the outbreak of the pandemic. The Second Family Relief Act will probably reduce tax revenue by a further €3 billion. In addition, local government budgets remain reliant on aid, and central government's contribution to compensation for shortfalls in local business tax will not continue next year. It would be advisable to combine further crisis support for local govern-

9 See Deutsche Bundesbank (2020b), pp. 88 ff. Figures including off-budget entities are now available for the second quarter. While the core budgets posted a deficit of €26 billion, the off-budget entities recorded a surplus of €6½ billion (€2 billion in the same quarter of the previous year). The deficit in the core budgets thus significantly overstates the overall burden. In the quarter under review, the opposite could be true because of possible deficits in off-budget entities with their own borrowing authorisations.
10 See Deutsche Bundesbank (2020c).

ments with a reform of local government financing.[11]

Future challenges likely to vary quite widely

Given the high measure of uncertainty, it seems reasonable, for the time being, not to adopt any consolidation measures for the medium term. Decisions of this kind should not be made until state governments are drawing up draft budgets without an escape clause. The challenges that this will pose for individual state governments are likely to vary quite widely. Their structural budget positions prior to the coronavirus crisis, their level of reserves and their cyclical borrowing options will all play a role.[12]

Social security funds

Pension insurance scheme

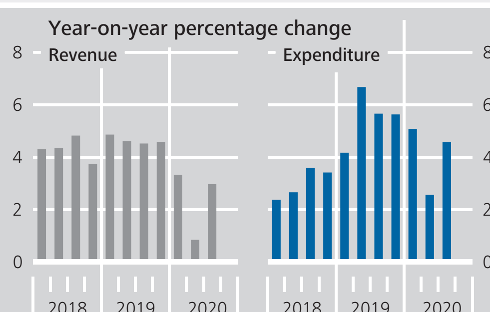
Significant deficit in Q3

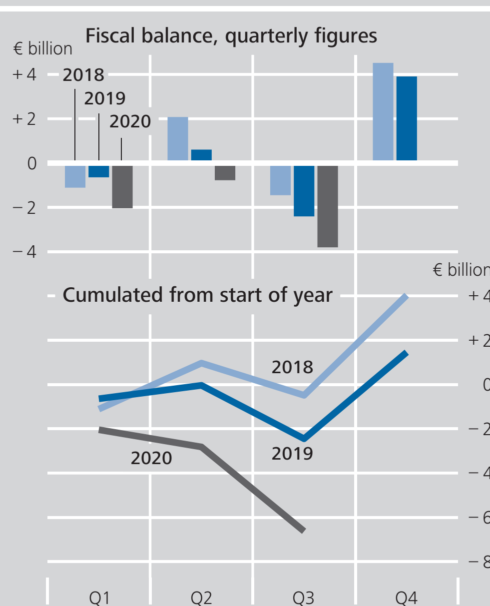
In the third quarter of 2020, the statutory pension insurance scheme recorded a deficit of €4 billion, which was €1½ billion higher than it had been a year earlier. Contribution receipts rose by 2½%, bolstered by contributions paid for recipients of unemployment and short-time working benefits. In addition, the scheme retroactively received social contributions that had been deferred in the initial phase of the pandemic. Expenditure rose sharply by 4½%, with pensions increasing by an average of just over 3½%.

Perceptible deficit for year as a whole, too

Over the first three quarters of the year, the pension insurance scheme thus recorded a cumulated deficit of €6½ billion. Although the coronavirus pandemic is continuing to have a negative impact on the scheme's finances, it is likely to record a surplus in the final quarter. As is usual for the time of year, contribution receipts will then be comparatively high. However, a perceptible deficit is likely to be recorded for the year as a whole. This constitutes a substantial deterioration in the scheme's finances compared with the surplus of €2 billion recorded for 2019. The deficit will be funded from the sustainability reserve. By the end of 2020, this reserve could fall to just over 1.5 times the scheme's average monthly expenditure. That would still leave it around €32 billion above the lower limit of 0.2 times the scheme's average monthly expenditure.

Finances of the German statutory pension insurance scheme*





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

Rising deficit likely next year

Next year, it is likely that the pension insurance scheme's finances will deteriorate and its deficit will rise. On the revenue side, the COVID-19 pandemic will probably continue to weigh on contribution receipts. By contrast, government funds will still largely reflect the favourable

11 See Deutsche Bundesbank (2020d).
12 See Deutsche Bundesbank (2020e) for more details.

Annual pension adjustments in need of reform

Annual pension adjustments are determined by three factors: the change in insured persons' average earnings subject to compulsory contributions, the cost or saving derived from the change in the pension insurance scheme contribution rate and the change in the pensioner ratio via the sustainability factor. In simplified terms, the pensioner ratio is the ratio of pension recipients to contribution payers.

However, the relevant data on earnings subject to compulsory contributions are not yet available when the level of the annual pension adjustment is determined. For this reason, the mid-year adjustment is based initially on the figures that are already available for prior-year average gross wages and salaries (hereinafter referred to simply as wages). In the next year, this is corrected as necessary: if developments in earnings subject to compulsory contributions end up differing from wage developments, this will be corrected retroactively in the then upcoming pension adjustment. This thus ensures that pensions are ultimately based on earnings subject to compulsory contributions.

In 2021, then, the adjustment will be based initially on the – in all likelihood lower – wages in the crisis year of 2020. This will be followed by a correction factoring in the change in average earnings subject to compulsory contributions in 2019. What makes 2021 different from other years is that a revision of the pension statistics will cause earnings subject to compulsory contributions to be lower in 2019, curbing their increase compared with the unrevised figures for 2018. Growth in earnings subject to compulsory contributions is therefore likely to have been markedly weaker than the rise in wages. Taken by itself, this would make the pension cuts already on the horizon due to falling wages in 2020 even deeper.[1] However, as the pension adjustment formula contains a safeguard clause ruling out the option of pension cuts, a zero adjustment is made.

By contrast, the adjustment in mid-2022 is then likely to be exceptionally high. First, the wage figures on which the pension adjustment is initially based could rise quite steeply again in 2021 compared with the previous crisis year. Second, the subsequent correction, which will capture the differences between earnings subject to compulsory contributions and wages in 2020, is likely to have a positive impact on the 2022 pension adjustment: growth in earnings subject to compulsory contributions in 2020 is expected to have been far more stable than wage growth.[2] It should be noted that the major adjustment in 2022 will be based on pensions that were not cut in 2021 owing to the safeguard clause. In the years after the safeguard clause has been activated, waived pension cuts are supposed to be compensated for, which would reduce pension increases. However, this mechanism, known as the catch-up factor, has been suspended up to and through 2025.

When the next adjustment is made in mid-2023, the subsequent correction factor will offset the fact that, in 2021, wages will (probably) be back to rising more steeply than earnings subject to compulsory contributions.[3] This will reduce the annual pension adjustment again.

Another source of pension adjustment fluctuations is the sustainability factor. This decreases (increases) the pension adjustment if the number of standard pensions[4] grows faster (more slowly) than the number of average contribution payers. The impact on pen-

1 See Deutsche Rentenversicherung Bund (2020).
2 This is due, in particular, to the fact that short-time working benefits and unemployment benefits are recorded differently here. Neither are wage components. Wages are falling sharply this year due to unemployment and short-time working. However, payments for recipients of unemployment and short-time working benefits are included as part of earnings subject to compulsory contributions, with pension insurance scheme contributions being paid on 80% of earnings replaced by the transfers.
3 The impact of the short-time working and unemployment factors will then reverse compared with the previous year.
4 The standard pension is a pension with 45 earnings points, which are accrued with consistently average earnings after around 45 years of contributions.

sion funding is thus reduced if growth in the contribution base is weaker than the increase in expenditure that it is supposed to cover. Even in this crisis period, the number of standard pensions is growing relatively steadily. However, the number of average contribution payers is fluctuating, and the fluctuations in this number are even more pronounced in the sustainability factor because, owing to the delayed availability of data, provisional values have to be used initially. Errors resulting from this are then corrected in the following year on the basis of actual developments. On balance, the 2020 annual pension adjustment was too high owing to the sustainability factor. While this should then be corrected in 2021, such a correction is prevented by the safeguard clause. As the catch-up factor has been suspended, it is not possible to offset this effect by reducing the next pension increase, either.

All in all, rather erratic pension adjustments are to be expected over the next few years. The reasons for this are complicated and difficult to comprehend. The combination of various statistical factors with the suspension of the catch-up factor for waived pension cuts means that, owing to the major economic volatility caused by the crisis, the replacement rate is ultimately going to be significantly higher than envisaged based on the pension adjustment formula. This will require a corresponding increase in contributions and tax resources.

Against this background, it would be worth fundamentally reforming the pension adjustment formula. Care should be taken to avoid pronounced fluctuations stemming not least from foreseeable distortions in proxies. Pension adjustments and changes in the replacement rate should not be the result of more or less random forces.

wage and labour market developments of 2019.

General annual pension adjustment unlikely in 2021

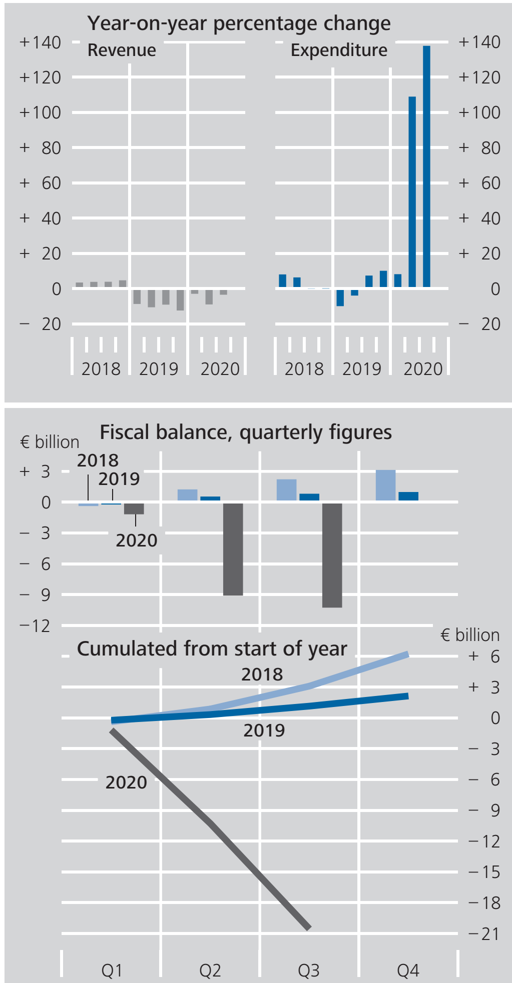
A general annual pension increase is unlikely in mid-2021, which will curb expenditure growth.[13] The annual pension adjustments are based, not least, on the change in average gross wages and salaries in the previous year. This figure is likely to fall. However, a pension cut is prohibited by law.[14] One factor driving up expenditure (in addition to annual average pension growth) is the increase in the number of pensions. Moreover, the supplementary contribution rates to the statutory health insurance scheme, which are partially funded by the pension insurance scheme, are likely to rise somewhat as well.

Economic downturn will have erratic impact on annual pension adjustments in coming years

The current economic downturn will continue to affect annual pension adjustments in subsequent years. Corrections due to lags in data availability will make them erratic. The correction factors will probably deliver a strong boost to the increase in 2022 but have a dampening effect in the years that follow. All in all, it would seem advisable to reform the annual pension adjustment formula in order to make pension increases more steady, less erratic and, overall, less complex (see the box on pp. 72 f.). The suspension of the catch-up factor as part of the pension guarantee up to 2025 has intensified funding pressure on the expenditure side. The contribution rate is therefore likely to rise earlier than was assumed before the pandemic. If this were to happen, central government would also have to provide more funds.

13 The fact that the eastern German level is to be gradually raised to the western German level will drive up expenditure somewhat. Consequently, pensions will increase by 0.2% on average across Germany in mid-2021.
14 Unlike after the financial and economic crisis just over a decade ago, a waived pension cut will not be compensated for with deductions on pension increases in the following years; the corresponding catch-up factor was suspended under the pension benefits package from 2018 up to and including 2025.

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

Very large deficit in Q3, too

The Federal Employment Agency continued to be substantially affected by the COVID-19 crisis in the third quarter of 2020, recording a deficit of almost €10½ billion in its core budget[15] (compared with a surplus of €1 billion last year). Revenue fell by 3½%. This was due, above all, to the contribution rate cut from 2.5% to 2.4% at the beginning of the year. Without the rate cut, revenue would have stagnated. On the revenue side, the Federal Employment Agency is thus the branch of social security hardest hit by the crisis. Unlike the other social security fund institutions, the agency's revenue-side burdens due to the crisis are not being alleviated by contributions paid for recipients of short-time working and unemployment benefits. The economic downturn is having a far stronger impact on its expenditure, which was €11 billion higher (+140%) than in the same quarter last year. Spending on unemployment benefits rose by more than 50%. The vast majority (€8½ billion) of this increase was attributable to short-time working benefits. Social contributions paid by the Federal Employment Agency on behalf of enterprises as an exceptional crisis measure accounted for around half of this. Although short-time working had already peaked in April, expenditure was somewhat higher in the third quarter than in the second, as the Federal Employment Agency is reimbursing enterprises' payments retroactively.

Central government supporting Federal Employment Agency with substantial loan

For the year as a whole, the Federal Employment Agency's deficit could reach around €30 billion. In running this deficit, the Federal Employment Agency is making a crucial contribution to the stabilisation of the economy. It holds a reserve for the purpose of funding deficits. This reserve totalled €25½ billion at the end of 2019, although press reports indicate that only around €19 billion can be liquidated this year. Central government has granted the agency a multi-year loan to close the remaining funding gap.

Central government funds to stabilise contribution rate next year

Next year, the Federal Employment Agency's finances are likely to improve again once the crisis gradually eases, as is generally expected. Nonetheless, without a contribution rate increase and central government assistance, it is still likely to record a large deficit. The draft

15 Excluding the civil servants' pension fund. Transfers to the fund are thus an item of expenditure that lowers the core budget balance. These transfers have been suspended from the second quarter of 2020 until the end of 2021 because of the COVID-19 crisis. The Federal Employment Agency's budget plan had envisaged transfers of just over €½ billion for 2020 as a whole. The absence of these transfers is diminishing the balance of the civil servants' pension fund, which is assigned to the government sector in the national accounts.

central government budget for 2021 does not envisage any repayments of the multi-year loan by the Federal Employment Agency. Instead, it includes a further grant of €3 billion to the Federal Employment Agency and liquidity loans of up to €18 billion. At the end of 2021, it appears that all loans to the Federal Employment Agency that are still outstanding at that point will be forgiven.

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