Public finances

Public finances in Germany[1]

General government budget

Public finances again providing strong support to the economy in 2021 …

Public finances are continuing to provide significant support to the economy in 2021. The dedicated assistance measures and the regular social systems are still mitigating the economic fallout from the coronavirus crisis. To combat the pandemic, sizeable funds are being channelled into healthcare; for example, for vaccines and tests. Beyond the coronavirus response measures, various structural measures are providing relief to households in particular; for example, the solidarity surcharge has been partially abolished and child benefits have been raised significantly.

… deficit likely to continue rising

As a result, the general government deficit is likely to continue rising in 2021 (in 2020 it stood at 4.2% of gross domestic product (GDP)). Germany's April stability programme envisages a very high deficit of 9% of GDP (see the table on p. 63). This figure fully includes all of the buffers in the central government budget. As things stand, they will probably be far from exhausted. Last year, too, the final deficit was significantly below the figure budgeted for by the government. All in all, the deficit ratio could approach around 6% this year. The debt ratio could also be lower than the 74½% budgeted in the stability programme (just under 70% at the end of 2020). However, uncertainty remains very high.

Fiscal policy support still needed in the crisis; fiscal leeway available for stabilisation

To date, the fiscal policy response in Germany has been flexible and, overall, targeted to the difficult crisis situation. Although, in some cases, the specific design and implementation of individual measures are not entirely convincing,[2] it should be borne in mind that action sometimes had to be taken fairly swiftly and subsequently fine-tuned as the pandemic unfolded, for example. As long as the restrictions continue, targeted fiscal assistance will remain important. As restrictions ease, however, it should be phased out. Where necessary, it will still be possible to fine-tune fiscal stabilisation measures at a later point in time. There is sufficient fiscal leeway for such adjustments, particularly given the favourable state of Germany's public finances before the crisis.

Deficit expected to shrink considerably in 2022

If the pandemic-related restrictions are increasingly lifted as the year progresses, the deficit is likely to shrink considerably in 2022. The burden on public finances will then be relieved by the ongoing recovery in the German economy and the fact that numerous support measures will no longer be necessary and will be phased out; in this respect, the fiscal policy stance is not restrictive.

Decision on necessity of escape clauses should wait until later this year

Looking at the fiscal rules, there are already indications that the escape clauses should remain active in 2022. This applies to both the EU rules and the debt brake. However, there is much to be said for putting off that decision until later this year. It will then be much easier to assess whether an elevated deficit is actually still necessary in order to overcome the crisis – not least because there will be more information on further developments in the pandemic and in the economy as a whole. In addition, national budgets are not usually passed until the end of the year anyway; in view of Germany's upcoming general election, the central government budget probably will not be adopted until next year. Moreover, even without the escape clause, the fiscal rules provide scope for

1 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 first quarter of 2021 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.
2 For example, in some cases it took a long time for business aid to be paid out. As a particularly targeted measure, tax loss carrybacks could also have been expanded further.

Key figures of the Federal Government's stability programmes*

Item	2019	2020	2021	2022	2023	2024	2025
Real GDP growth (%)							
April 2021	0.6	– 4.9	3.0	2.6	1.2	1.2	1.2
April 2020	0.6	– 6.0	.	.	.	.	.
April 2019	1.0	1.6	1.1	1.1	1.1	.	.
General government fiscal balance (% of GDP)							
April 2021	1.5	– 4.2	– 9	– 3	– 1½	– ½	0
April 2020	1.4	– 7¼	.	.	.	.	.
April 2019	¾	¾	½	½	½	.	.
Structural fiscal balance (% of GDP)							
April 2021	0.9	– 2.0	– 7¾	– 2¾	– 1¼	– ½	0
April 2020	1.3	.	.	.	.	.	.
April 2019	¾	½	½	¼	½	.	.
Debt level (% of GDP)							
April 2021	59.7	69.8	74½	74	73¼	72	69¼
April 2020	59.8	75¼	.	.	.	.	.
April 2019	58¾	56½	54¾	53	51¼	.	.

Sources: Federal Ministry of Finance, Federal Statistical Office, Bundesbank calculations. * The stability programmes are based on the Federal Government's macroeconomic projection from January of the same year.
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reducing deficits in a cyclically appropriate manner. More specifically, under the debt brake, the available reserves can be used to comply with the ceilings. The EU rules normally require structural consolidation of 0.5% of GDP per year. This should be easily achievable because of the many assistance measures that are likely to expire, which will count as consolidation (see pp. 76 ff.).

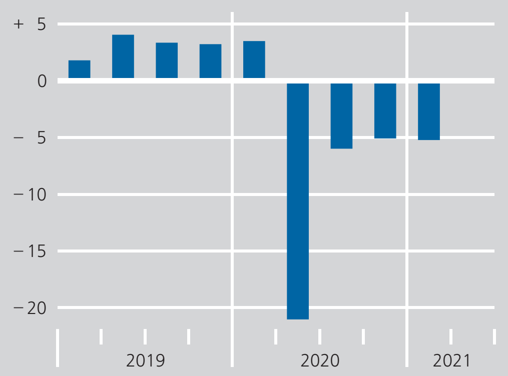
Fiscal rules do not prevent additional spending on future challenges

The debt brake is sometimes accused of having excessively restricted government activities in recent years. However, primary expenditure (total expenditure excluding interest expenditure) has also increased significantly under the debt brake regime. After the crisis, the structural ratio of primary expenditure to GDP could reach a new high. Its previous peak since the reunification of Germany, at around 46%, was recorded at the beginning of the 1990s; before the crisis, in 2019, it stood at around 45%.[3] The fiscal rules are not intended to limit government spending. Rather, the rules are meant to keep the government budget in an agreed state of balance or to revert it to such a state. This means matching revenue and expenditure. In view of the dynamic expenditure growth, the fiscal rules cannot be blamed for the fact that more funds were not used to address important future challenges. Instead, it seems that this was largely the result of constraints in planning and approval processes, or prioritisation of other issues. When budget limits have been exhausted, there are various possible courses of action to boost funds. If the fiscal burden is not to be increased, e.g. due to negative impacts on growth, political priorities or adopted spending programmes would have to be readjusted.

3 In the case of the structural ratio, specific temporary effects (such as the temporary coronavirus response measures) and cyclical effects are disregarded (data based on the Bundesbank's estimation framework).

Tax revenue*

Year-on-year percentage change, quarterly figures



Source: Federal Ministry of Finance. * Comprises joint taxes as well as central government taxes and state government taxes. Including EU shares in German tax revenue, including customs duties, but excluding receipts from local government taxes.

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Tax revenue

Type of tax	Q1 2020	Q1 2021		Estimate for 2021[1]
	€ billion		Year-on-year change %	Year-on-year change %
Tax revenue, total[2]	181.4	171.9	− 5.2	+ 4.3
of which:				
Wage tax	53.4	50.9	− 4.7	+ 1.0
Profit-related taxes	34.6	35.5	+ 2.6	+ 6.0
Assessed income tax[3]	18.7	17.8	− 4.7	+ 3.7
Corporation tax	8.5	10.2	+ 20.1	+ 16.0
Non-assessed taxes on earnings	4.9	4.3	− 13.8	− 0.5
Withholding tax on interest income and capital gains	2.5	3.2	+ 31.0	+ 10.9
VAT[4]	60.1	54.8	− 8.8	+ 11.8
Other consumption-related taxes[5]	20.5	19.5	− 5.0	+ 2.0

Sources: Federal Ministry of Finance, Working Party on Tax Revenue Estimates and Bundesbank calculations. 1 According to official tax estimate of May 2021. 2 Comprises joint taxes as well as central government taxes and state government taxes. Including EU shares in German tax revenue, including customs duties, but excluding receipts from local government taxes. 3 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 lotteries, beer, and fire protection.

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Budgetary development of central, state and local government

Tax revenue

Legislation changes and weak economy reduced Q1 revenue

In the first three months of 2021, tax revenue[4] continued to fall significantly on the year (-5%; see the adjacent chart and table). One reason for this was that tax revenue had not yet been much affected by the incipient coronavirus crisis in the first quarter of 2020. A very substantial role was played by tax measures, particularly those affecting VAT. As VAT is paid with a lag of up to two months, the temporary VAT cut in 2020 still had a perceptible effect. In addition, import VAT now falls due one and a half months later than before. However, other substantial legal changes also drove down revenue. Since the beginning of the year, most taxpayers have no longer had to pay the solidarity surcharge. Furthermore, the income tax allowances and the income tax scale were, as usual, adjusted to developments in the minimum subsistence level and the inflation previously expected for the preceding year.[5] As specified in the coalition agreement, child benefits were raised significantly. As these are deducted from wage tax revenue, this increase further reduced receipts.

Sharp reduction in VAT and wage tax revenue

Owing, amongst other things, to the aforementioned legal changes, wage tax revenue fell by 4½%. In addition, short-time working continued to dampen revenue significantly.[6] By

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 Income tax brackets were shifted 1.52% to the right. This measure was intended to ensure that income growth in line with consumer price inflation for households in 2020 would not be subject to higher tax rates. However, actual inflation (0.7%) was considerably below the figure originally estimated. Nonetheless, this estimation error will probably be broadly offset by an opposing estimation error this year with the tax scale adjustment at the beginning of 2022, which has already been set.
6 As a result of short-time working arrangements, wages are lower, and short-time working benefits themselves are not taxed. However, for the purposes of income tax assessment, short-time working benefits are factored in when the tax rate is determined (Progressionsvorbehalt), resulting in a moderate increase in assessed income tax revenue in the following year.

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

Item	2020	2021	2022	2023	2024	2025
Tax revenue[1]						
€ billion	739.7	773.5	812.1	848.4	885.4	917.5
% of GDP	22.2	22.1	22.0	22.4	22.8	23.0
Year-on-year change (%)	– 7.5	4.6	5.0	4.5	4.4	3.6
Revision of previous tax estimate (€ billion)	11.4	– 2.7	– 3.9	1.1	6.4	9.1
Real GDP growth (%)						
Spring projection (April 2021)	– 4.9	3.5	3.6	1.1	1.1	1.1
Autumn projection (October 2020)	– 5.5	4.4	2.5	1.0	1.0	1.0
Nominal GDP growth (%)						
Spring projection (April 2021)	– 3.4	5.3	5.2	2.6	2.6	2.6
Autumn projection (October 2020)	– 3.8	6.0	4.3	2.6	2.6	2.6

Sources: Working Party on Tax Revenue Estimates 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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contrast, receipts from profit-related taxes rose by a total of 2½%. Corporation tax saw strong growth of 20% because of a large increase in net payments for past years. By contrast, there was a fall in advance payments for the current year, a major revenue item. Receipts from assessed income tax declined by 4½%; here, advance payments for the current year were almost unchanged. Withholding tax on interest income and capital gains saw a strong rise in revenue. This is likely to have been caused mainly by capital gains – probably also in connection with higher stock market prices. Revenue from non-assessed taxes on earnings fell considerably. This chiefly comprises investment income tax on dividends, which was adversely affected by significantly lower profits. VAT revenue dropped by 9% – probably primarily as a result of the aforementioned tax measures.

Significant rise in tax revenue expected for year as a whole

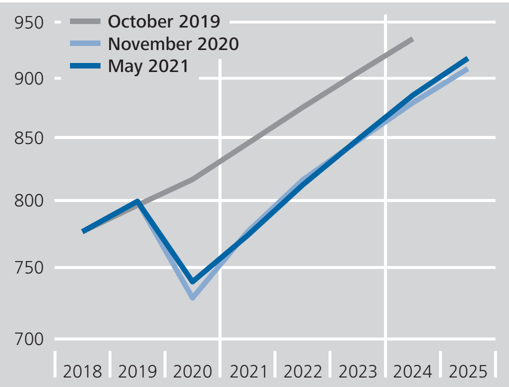
According to the latest official tax estimate, tax revenue will rise by 4½% on the year in 2021. This is due to the pick-up in economic activity. On balance, tax measures are significantly reducing the growth rate. New tax relief measures (losses) outweigh the expiry of crisis response measures (additional revenue). Revenue losses are primarily due to the partial abolition of the solidarity surcharge and the aforementioned adjustments to the income tax scale. Furthermore, firms are allowed to write off capital equipment faster, thus reducing revenue from taxes on earnings. In addition, the rise in child benefits is still more somewhat more substantial than the de facto halving of the child bonus. The corresponding deductions from wage tax are thus slightly higher on balance. The (mostly temporary) VAT revenue losses remain close to the high level recorded in 2020. A revenue-increasing factor is the assumption that the majority of the tax payments deferred in 2020 will now be made.

Dynamic growth forecast to continue in the coming years

In 2022, revenue growth is expected to be somewhat stronger still, at 5%. Once more, this hinges on growth in the macroeconomic reference variables. Progressive taxation will support growth somewhat more strongly again. The various tax measures will continue to place a significant dampener on the rise in revenue: tax relief measures will cause further losses in revenue from wage tax and taxes on earnings (faster write-offs and the further adjustment to the income tax scale). Furthermore, to a large extent, the back-payments of deferred taxes will cease to affect the year-on-year figures. By contrast, there will be additional receipts from VAT as a result of the support measures largely expiring. In the subsequent years up to 2025, revenue is projected to rise by an average of 4%. The tax estimate is based on the legal status quo, and legislation

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

€ billion, log scale



Sources: Working Party on Tax Revenue Estimates. * General government tax revenue according to the official tax estimates.
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changes play hardly any role on balance. The forecast is therefore largely based on assumptions regarding macroeconomic developments and progressive taxation.

Downward revision for 2021 and 2022, upward revisions for medium term

Compared with the previous estimate in November 2020, the downward revision amounts to €2½ billion in 2021. Tax measures that were not yet taken into account then are significantly reducing revenue. First and foremost, these are lower income tax rates, higher child benefits and the Third Coronavirus Tax Assistance Act *(Drittes Corona-Steuerhilfegesetz)* (including the 2021 child bonus). By contrast, the surprisingly favourable revenue developments recorded in the 2020 budget outturn are, in part, continuing into 2021. Furthermore, the macroeconomic assumptions are conducive to somewhat higher revenue, even though GDP growth was revised downwards. The Working Group has reduced its estimate for 2022 somewhat more significantly, by €4 billion, as losses generated by new legislation changes are even more substantial. Above all, these comprise faster tax write-offs for information technology and the additional income tax relief. Under the third Coronavirus Tax Assistance Act, restaurant meals will be subject to a reduced tax rate in 2022 too. By contrast, revised macroeconomic assumptions will lead to significantly higher receipts – including in the years that follow. Primarily for this reason, the Working Group has raised the estimates for the subsequent years (by as much as €9 billion in 2025). Although legislation changes made in the intervening period will continue to reduce revenue in the medium term, their effect will wane over time. This is mainly because losses caused by faster write-downs will tail off.

Compared with pre-coronavirus outlook, macroeconomic losses and tax cuts weighing considerably on revenue

Compared with the pre-crisis estimate of autumn 2019, there are still considerable revenue losses (see the adjacent chart): the downward revision for this year amounts to just over €70 billion (2% of GDP). The revision for the subsequent period is significantly lower but is still just under €50 billion in 2024 (1½% of GDP). Legislation changes and revisions to macroeconomic assumptions each account for roughly half of the revenue losses in 2024. Most of the legislation changes are unrelated to the coronavirus pandemic. These include, in particular, the partial abolition of the solidarity surcharge, wage and income tax relief and the increase in child benefits.

Central government budget

Very high deficit in Q1 2021

In the first quarter of 2021, the central government budget was almost €53 billion in deficit after having posted a surplus of €2 billion a year earlier. Revenue fell by €17 billion (19%). Most of this decline is attributable to the considerable decrease in tax receipts (-€11 billion). These losses were driven, first, by the coronavirus response measures, particularly those affecting VAT. Second, they reflected the €4 billion in additional transfers made to the EU budget, which are deducted from tax revenue; around half of this sum was due to Brexit. In addition, there was no profit distribution from the Bundesbank, which had amounted to €6 billion a year earlier. Expenditure soared by €37 billion (41%), with current transfers accounting for €23 billion. Of this sum, an additional €11 billion was transferred to the social security funds alone. This included, not least, special coronavirus-related transfers to the Federal Employment Agency and the health fund. Bridging aid and compensation for lost turnover totalling €11 billion also led to a strong rise in current transfers (to enterprises). In other expenditure, transfers to general government rose by just over €6 billion: additional expenditure of €4 billion to state governments mainly comprised compensation for empty hospital beds. In addition, the energy and climate fund received its annual transfer of €2½ billion earlier than usual. Investment recorded growth of €9 billion, which was fully attributable to a loan to the Federal Employment Agency. By contrast, interest expenditure fell again (-€1½ billion), mainly as a result of higher premiums on securities issued.

2021 supplementary budget: borrowing authorisation increased to €240 billion

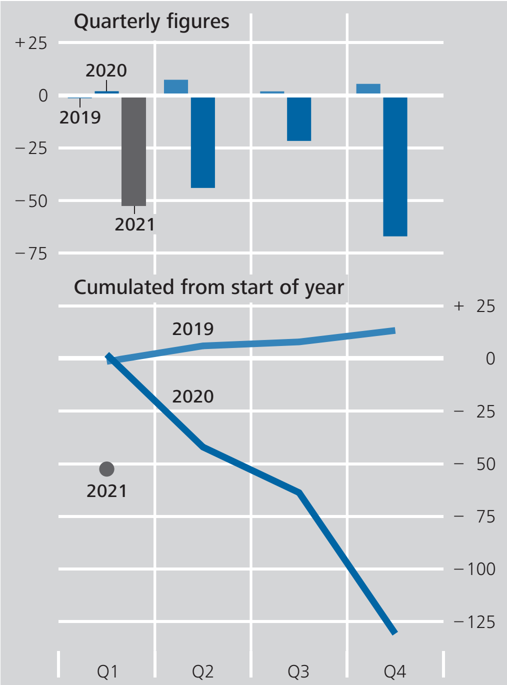
The 2021 central government budget passed last December envisaged a deficit of €180 billion. It contained global (still unspecified) additional expenditure of €35 billion, as well as €40 billion in business aid (which reached a total of €18 billion last year). The budget thus opened up ample room for manoeuvre. However, the pandemic caused a greater reduction in economic activity at the start of the year than had been expected and also created significant additional requirements in the healthcare system. In February, the government therefore decided to provide additional assistance to households and enterprises. It passed a supplementary budget encompassing, not least, the expected budget burdens generated by this assistance. Above all, it substantially increased bridging aid for enterprises (+€26 billion). All in all, exceptionally high net borrowing of €240 billion is now planned for 2021.

Supplementary budget exceeds standard limit under debt brake by €216 billion

It is the structural budgetary position that is relevant for the debt brake (for more details, see the table on p. 68). This figure is calculated by deducting the cyclical effect and financial transactions and factoring in the balance of various off-budget entities. After taking account of the supplementary budget, borrowing is set to exceed the standard limit by €216 billion. While this has been covered by activating the escape clause, corresponding repayments will be required going forward. The Bundestag

Central government fiscal balance*

€ billion



Source: Bundesbank calculations based on data from the Federal Ministry of Finance. * Core budget excluding off-budget entities. Not adjusted for financial transactions or cyclical effects.

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thus agreed annual repayments of just under €13 billion between 2026 and 2042 for the planned exceptional borrowing in 2021. There are also repayment obligations stemming from borrowing in the previous year amounting to €2 billion per year from 2023 to 2042.

Budget estimates appear very cautious, outturn could again be much more favourable

As things currently stand, the supplementary budget appears to be extremely generous. Most of the anticipated coronavirus burdens have been assigned to a specific budgetary item with a concrete amount and are no longer contained in the high general provision (global additional spending). The general provision has nevertheless been expanded slightly to €36 billion compared with the original budget. Moreover, the various amounts budgeted for business aid may well prove to be an additional buffer of a similar size to the general provision. The latest tax estimate also foresees additional revenue of €8½ billion. Furthermore, guarantees (including public loan guarantees) and debt servicing may place less of a strain on the

Budget data and benchmark figures from the Federal Government's fiscal planning up to 2025* and the result for the debt brake

€ billion

Item	Actual 2020	Supplementary budget 2021	Benchmark figures 2022	Benchmark figures, fiscal plan 2023	2024	2025
Core budget figures						
1. Expenditure[1]	441.8	547.7	419.8	397.5	402.7	403.4
Year-on-year change (%)	28.7	24.0	– 23.4	– 5.3	1.3	0.2
of which:						
1.a Investment	50.3	59.3	50.0	50.0	50.0	50.0
1.b Net global spending increases/cuts (from 2022: less 1.5% of expenditure)	–	27.3	s 5	s – 6	s – 6	s – 6
2. Revenue[1,2]	311.1	307.3	338.1	356.8	375.0	393.2
of which:						
2.a Tax revenue[1]	283.3	284.0	308.2	322.8	335.0	347.4
2.b Global shortfall; from 2024: need for action[3]	–	– 3.0	.	.	4.9	15.2
3. Fiscal balance (2.–1.)	– 130.7	– 240.4	– 81.7	– 40.7	– 27.7	– 10.2
4. Coin seigniorage	0.2	0.2	s 0.2	s 0.2	s 0.2	s 0.2
5. Transfer to (–)/withdrawal from (+) reserves	–	–	–	32.2	16.0	–
6. Net borrowing (–)/repayment (+) (3.+4.+5.)	– 130.5	– 240.2	– 81.5	– 8.3	– 11.5	– 10.0
Supplementary figures for the debt brake						
7. Cyclical component in the budget procedure	– 44.6	– 24.0	– 6.1	– 4.7	– 2.7	0.0
8. Balance of financial transactions	– 6.6	– 5.4	.	.	.	.
9. Balance of incorporated off-budget entities	27.7	– 17.6	.	.	.	.
9.a Energy and Climate Fund (from 2022: based on autumn 2020 fiscal plan)	25.3	– 13.8	– 10.2	– 4.3	– 1.5	.
9.b Flood Assistance Fund	– 0.4	– 0.5	.	.	.	.
9.c Fund to Promote Municipal Investment	– 1.0	– 1.5	.	.	.	.
9.d Digitalisation Fund	1.3	– 1.8	.	.	.	.
9.e Fund for Primary School-Age Childcare Provision	2.5	–	.	.	.	.
10. Structural net borrowing (–)/repayment (+) (6.–7.–8.+9.)	– 51.5	– 228.4	.	.	.	.
11. Amount exceeding ceiling (14.–13.–10.)	39.8	216.4	[4] 71	–	–	–
12. Outstanding repayment amount, escape clause	39.8	256.2	327	325	323	321
13. Repayment amount due[5]	–	–	–	2.0	2.0	2.0
14. Regular ceiling: structural net borrowing of 0.35% of GDP[6]	– 11.7	– 12.1	– 11.7	– 12.2	– 12.7	– 13.0
Memo items: Relief from global items, withdrawal from reserves, need for action (2.b–1.b+5.)	.	.	.	38.2	26.9	21.2

* 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 (figures estimated from 2022 onwards). **3** Shown here on the revenue side. May partly have been booked as reducing expenditure. **4** Derived from figure for annual repayment requirement of €18.9 billion from 2026 onwards. **5** Repayment plan for the amount from 11. (a) 2020: 1/20 per year from 2023 to 2042; (b) 2021 and 2022: 1/17 per year from 2026 to 2042. **6** This refers to GDP in the year before the budget is prepared (GDP based on 2021 Annual Economic Report).

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budget than planned. It is therefore possible that the additional scope for borrowing planned into the supplementary budget may not be needed (as was the case with the scope planned into the second supplementary budget last year). This would also significantly reduce the repayments due as of 2026.

Benchmark figures up to 2025: recourse to escape clause in 2022 plus reserves create leeway

At the end of March, the Federal government adopted the benchmark figures for the 2022 budget and for the medium-term fiscal plan up to 2025. In a departure from last autumn's plans, it is envisaged that the debt brake escape clause will be activated again for 2022. Net borrowing of €81½ billion is planned for 2022, €70 billion more than in the previous fiscal plan. Of this amount, €28 billion is attributable to the decision not to withdraw funds from the reserves. Consequently, this does not constitute an actual additional burden; the reserves – built up out of surpluses recorded since 2015 – are simply to be used at a later date. An additional lump sum of €10 billion has been set aside for domestic expenditure related to the pandemic. A further €10 billion is due to the decision not to implement the unspecified consolidation measures that were in the pipeline last autumn. Additional central government grants are envisaged to prevent social contribution rates from rising above 40% overall. As things currently stand, there will be no such assurance as of 2023. The expenditure framework is likely to scarcely be expanded as of 2024. The reserves (€48 billion) are to be fully depleted in 2023 and 2024. This will initially enable compliance with the debt brake rules largely without consolidation. The need for consolidation will be still be limited in 2024 (€5 billion), going up to €15 billion in 2025, the final year of the planning period.

After 2025 considerable challenges ahead for budgetary policymakers

The years following the medium-term fiscal planning period will be particularly challenging for budgetary policymakers. Repayments for borrowing in 2021 and 2022 will be due as of 2026. Even if these prove to be lower than currently estimated, they are still likely to have a considerable impact. In addition, the strain from demographic developments will intensify: central government will be confronted with a weaker growth trend in the various sources of tax revenue and a sharp rise in grants to the statutory pension insurance scheme. It is also not apparent how the government will deliver on commitments – for instance, for NATO defence expenditure and development aid (which already applies to the benchmark figures up to 2025). The new government should step up to the budgetary policy challenges in good time. It would, however, be critical if the debt brake escape clause were misused for promises to provide additional benefits after the election that would put a permanent strain on central government.

NGEU borrowing for grants will place strain on future central government budgets

The central government budget will be affected by the Next Generation EU (NGEU) programme, too (see also the information on pp. 76 ff.). Under this European programme, the EU borrows, inter alia, in order to fund sizeable grants to its Member States.[7] By 2026, the German central government budget is set to receive a total of around €30 billion; around €5 billion per year on average. These grants are also relevant in terms of the debt brake, as the incoming funds are classified as regular income and thus increase budgetary scope. However, this classification obscures the fact that the European debt incurred for the NGEU will need to be serviced by the Member States at some point in the future, and therefore out of the German central government budget, too.[8] In line with Germany's current share in the EU's economic output, central government will have to shoulder €100 billion in debt plus the corresponding interest charges. The Member States' funding contributions for repayment are to start in 2028 and be spread over three decades.

Economically speaking, German share in EU debt similar to central government debt; theoretically belongs under debt brake

Economically speaking, EU debt to be serviced by Germany is very similar to central government borrowing. The debt brake stipulates borrowing limits to ensure that future budgets are not overburdened. In addition to recording Germany's revenue from the NGEU in its entirety (as is currently planned), it would thus appear logical to take account of Germany's share in EU debt in the debt brake as well: consistent treatment of this item would mean including debt-financed EU grants in the amount of Germany's financing share in the debt brake at the time of payment. This would ultimately correspond to Germany's share in deficit at the EU level over the period from 2021 to 2026.[9] Immediately after the escape clause period, budgetary scope would be considerably narrower as a result. However, in return, central government's redemption payments for EU debt as of 2028 would then be neutralised in

7 The following considerations refer to the portion of EU debt used to finance grants. Member States are also granted loans. However, Germany is not planning on taking out such loans. If debtor Member States service these loans routinely, no financing requirements will arise for Germany. Borrowing funds to lend them to third parties is not counted under the debt brake, as such use of funds is classified as a financial transaction.
8 With the Act on Own Resources *(Gesetz zum Eigenmittelbeschluss)* Germany commits to providing financial contributions for debt servicing. Central government will service loans for grants (interest and repayments) in line with the German share of financing in the EU budget and in accordance with the repayment plan. This share broadly corresponds to relative economic output. Even if parts of the debt were to be repaid from new EU taxes, it would ultimately be taxpayers in the Member States who would foot the bill, thus eating into the fiscal scope for national budgets.
9 The deficit at EU level is likely to be broadly synchronised with the EU debt to be incurred for this purpose.

the debt brake, as is the case for financial transactions. By then, this approach would create more budgetary leeway than the procedure currently planned.

Uphold binding effect of fiscal rules

All in all, it would seem appropriate to include the national shares in EU debt in the debt brake. This would ensure that it is not possible to use such debt to undermine the debt brake. Effective and credible fiscal rules are essential for the entire European Union. They create confidence in sound public finances and protect monetary policy – one of the prime reasons they are anchored in agreements and constitutions. Far-reaching reforms of fiscal rules are currently the subject of debate in Germany and in the European Union. Decisions ultimately lie in the hands of policymakers. However, for a stable monetary union it is essential that reformed rules also safeguard the soundness of public finances. Fundamental adjustments should be discussed transparently and anchored at an institutional level. Rules will lose their credibility and binding force if they are simply bypassed or undermined.

Central government's off-budget entities record higher deficit in Q1 2021 due to stabilisation of renewable energy (EEG) levy

Central government's off-budget entities concluded the first quarter of 2021 with a deficit of €4½ billion (excluding the Financial Market Stabilisation Fund (SoFFin), bad banks and other entities that use commercial double-entry bookkeeping),[10] up from a deficit of just over €1½ billion in the same quarter a year earlier. Relatively high payments were made by the Energy and Climate Fund (ECF) at the start of this year. These payments stabilise the electricity levy to finance renewable energy (EEG levy). Particularly as electricity prices were lower last year as a result of the coronavirus crisis, there is a need for considerable grants. Revenue from the central government budget and from the sale of CO_2 certificates was not sufficient to balance this out. The Economic Stabilisation Fund (ESF) financed coronavirus aid for enterprises (in particular guaranteed assistance loans provided via the KfW). €1½ billion of new assistance was granted in the first quarter of 2021. No repayments on assistance granted last year have been recorded so far.

For year as a whole, off-budget entities' deficit may be similar to last year

The ECF's expenditure is likely to be considerably higher than its revenue for the rest of the year, too. The inflow of revenue from both European and national CO_2 certificates will increase in the following quarters; however, central government will not provide any more funding. The deficit for the year as a whole may still come in under the planned amount of €14 billion as there may be a delay in outflows from some programmes, as in previous years. Furthermore, the prices for European CO_2 certificates have risen sharply. The debt brake includes other off-budget entities in addition to the ECF, and these also have reserves. However, the total deficit of these other funds is likely to be much lower than that of the ECF. The ESF may even generate a surplus. When the expected economic recovery materialises, enterprises can be expected to pay back aid on balance. Surpluses are also anticipated for precautionary off-budget entities for pension burdens. Overall, the off-budget entities' annual deficit may be similar to last year.

State government budgets[11]

Deficit in Q1 2021: clear rise in revenue due to transfers …

The federal states' core budgets finished the first quarter of 2021 with a deficit of just under €3 billion. A year earlier they had recorded a surplus of €5 billion, but the coronavirus crisis was yet to make an impact back then. Overall, revenue went up sharply (+10%). While tax receipts declined significantly (-6½%, or -€5 billion), revenue from public administrations doubled. This is attributable in large part to central government aid for enterprises and hos-

10 According to figures from the Federal Ministry of Finance. The Ministry does not publish quarterly data for off-budget entities that keep commercial accounts, such as the bad bank FMS Wertmanagement. The deficit generated by SoFFin, which uses a single-entry accounting system, has also been excluded. It is largely a result of the loans passed on to FMS Wertmanagement. Overall, therefore, SoFFin's deficit does not increase central government's consolidated debt level.
11 The quarterly data on state government budgets are based on the monthly cash statistics for the core budgets.

pitals but also for local government (e.g. a sharp rise in central government's contributions to the accommodation costs of those receiving unemployment benefit II). The fact that revenue from public administrations varied greatly from state to state also points to transfers of funds from pandemic-related special funds. Many states set up such funds in 2020. These take vastly different forms, with funds either being injected up front or borrowing authorisations being granted.

... but expenditure growth very high

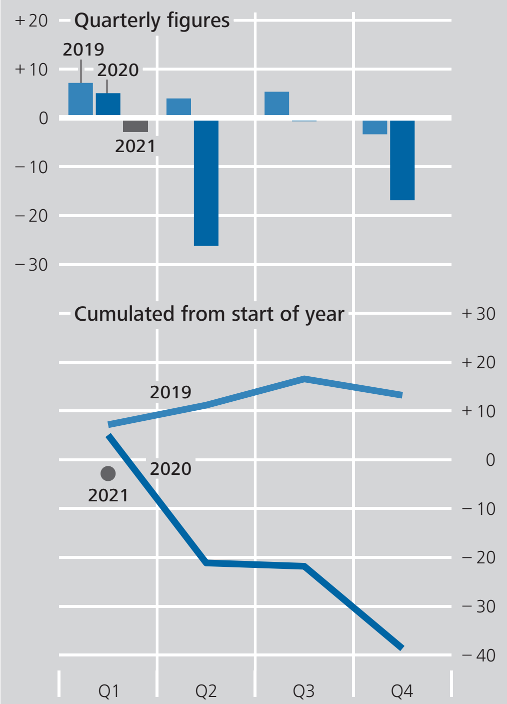
At 19%, expenditure growth was much stronger than growth in revenue. Spending on personnel, a particularly large expenditure item, rose at a much slower pace (+3½%). The very strong growth rates were instead attributable to the fact that large transfer inflows were disbursed. For instance, state government transfers to public administrations, especially to local government, went up by 18% overall. Growth in other operating expenditure was even stronger (+39%), chiefly driven by developments in North Rhine-Westphalia. In this state, in particular, it was apparent that parts of business aid had been recorded as other operating expenditure (as during the latter part of 2020). By contrast, the monthly statistics usually record business aid provided by central government – a major item – under other expenditure (+50%).

Harmonised recording and inclusion of coronavirus off-budget entities preferable

It would be helpful if state governments would harmonise their recording of the various coronavirus measures and provide detailed reports in a timely manner. For this, state governments' coronavirus off-budget entities would need to present comparable monthly data. As a result, reliable figures would be available relatively quickly. It would then be possible to adjust monthly balances by taking account of interlinkages with such special funds, thus rendering the underlying financial development more transparent. For instance, transfers from these special funds alleviate the strain on core budgets, yet – by the same token – providing advance financing for these funds places a strain on core budgets.

State government fiscal balance*

€ billion

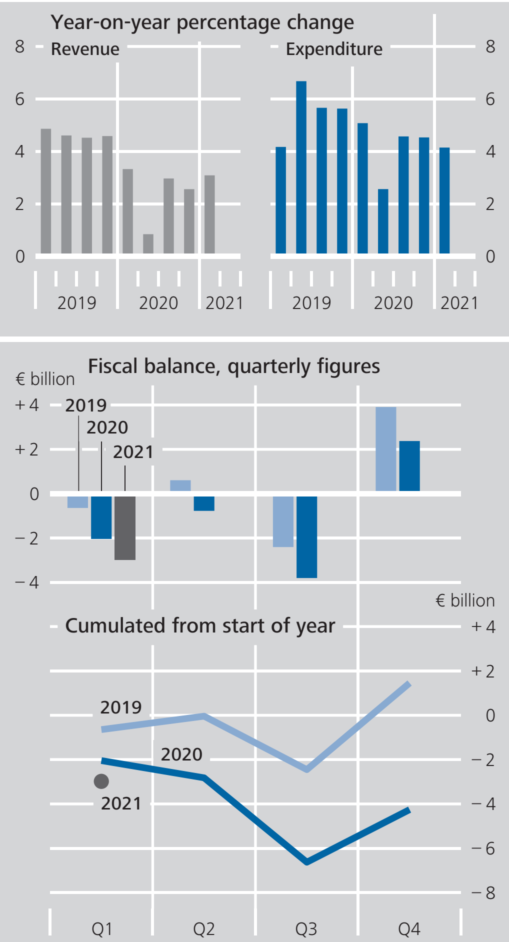


Source: Bundesbank calculations based on monthly data from the Federal Ministry of Finance. * Federal states' core budgets excluding off-budget entities.
Deutsche Bundesbank

For year as a whole, deficit expected to be high but declining on 2020, then recovery

For 2021 as a whole, state governments' core budget deficit is likely to be much lower than last year (2020: €39 billion). Expenditure will remain elevated as a result of the pandemic. Funds passed on from central government have a particular role to play here, but these do not strain state government budgets on balance. State governments are paying for coronavirus tests in schools, some of the costs for operating vaccination centres and compensation under the Protection against Infection Act *(Infektionsschutzgesetz)*. They are also absorbing some of their local governments' crisis-induced costs: in particular, by stabilising transfers within the municipal revenue-sharing scheme to limit local governments' revenue shortfalls resulting from the pandemic. According to the current tax estimate, state governments' tax receipts are set to rise moderately this year. Together with compensation for the child bonus pledged by central government, tax revenue is set to be €1½ billion higher than last autumn's expectations, but still almost €20 bil-

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

lion below the level anticipated prior to the crisis. Once the pandemic subsides and the economy starts to pick up again, tax revenue will recover further and temporary support and health measures will come to an end. State governments' deficits are thus likely to decline going forward. However, consolidation measures may become necessary in some cases in order to comply with the requirements of the states' debt brakes, including repayment conditions. Yet some reserves will probably be available, enabling the adjustment to be spread over a longer period.[12]

Social security funds

Pension insurance scheme

Marked rise in deficit in Q1: sound rise in revenue …

The statutory pension insurance scheme recorded a deficit of €3 billion in the first quarter of 2021. This constitutes a year-on-year deterioration of €1 billion. Overall, revenue went up by 3%. Contribution receipts rose by 2½%, driven by contributions on short-time working benefits and unemployment benefits. Furthermore, last year contributions were deferred at the beginning of the pandemic, depressing the revenue level. Central government funds rose by just over 3½% in line with adjustment rules. In addition, additional tax funds were granted for the basic pension which was introduced at the start of the year.

… outpaced by sharp rise in spending

At 4%, the rise in spending was much higher. The July 2020 annual pension adjustment accounted for 3½% of this rise and was accompanied by a slight rise in the number of pensions. So far the only strain emanating from the new basic pension is higher administrative costs; no increased pensions have yet been paid out. Supplementary contribution rates to the statutory health insurance scheme rose by around 0.3 percentage point (pp) at the beginning of the year. The pension insurance scheme is responsible for half of this, which is pushing up its expenditure accordingly. However, the pension contribution payments were first adjusted in March in line with the adjustment rules.

Growth in spending for year as a whole restrained as pensions will generally remain unchanged at mid-year

No general annual pension adjustment is scheduled for 2021. The pension adjustment formula would even have resulted in a cut due, inter alia, to the crisis.[13] However, the safeguard clause prevents this. Pensions in eastern Germany will nevertheless rise by 0.7 pp in July to ensure that they reach the level in western Germany by 2024, as planned. On an average

12 See Deutsche Bundesbank (2020a).
13 For more information on pension adjustments, see Deutsche Bundesbank (2020b).

for 2021, pensions will thus go up by a total of 2%, driven by last year's sharp mid-year adjustment. The number of pensioners is likely to increase by a little more than last year (2020: +½%) and higher additional contributions to the health insurance scheme will make themselves felt. Furthermore, the first payments of the new basic pension are due as of the second half of the year. The coronavirus crisis will continue to weigh on the revenue side throughout 2021.

Significant deficit expected for 2021 as a whole

All in all, a significant deficit is thus to be expected for 2021 as a whole, but it may be only slightly higher than that of last year (2020: just under €4½ billion, according to preliminary data). Deficits are set to rise more sharply in the years thereafter due, inter alia, to demographic trends.

Federal Employment Agency

Deficit very high at start of year

The Federal Employment Agency was hard hit by the coronavirus crisis in the first quarter of 2021, too, recording a deficit of €10 billion in its core budget.[14] This represented a deterioration of €9 billion compared with the same period last year, which was yet to be affected by the crisis.

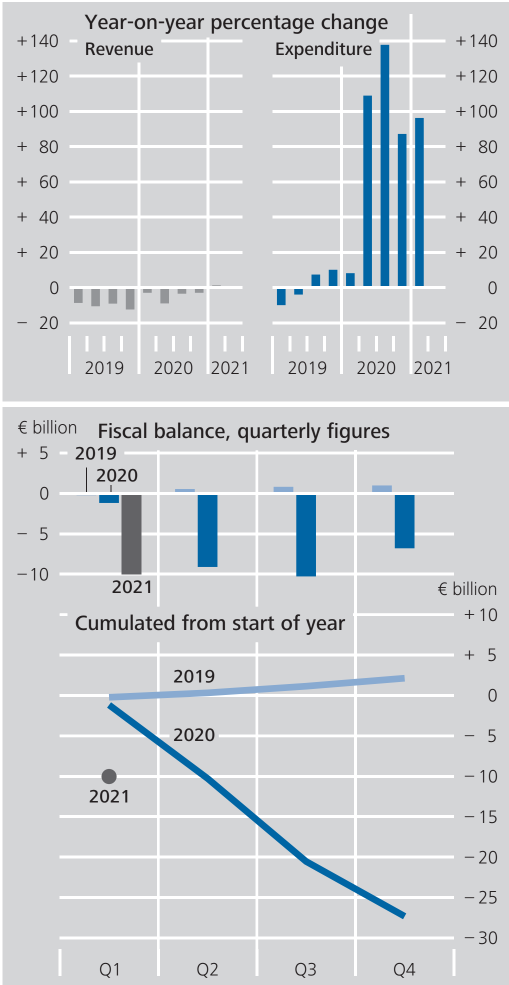
Revenue up overall due to higher contributions for insolvency benefit payments

Overall, the Federal Employment Agency's revenue recorded only a small increase. Contribution receipts declined slightly due to the crisis. However, in contrast to other branches of social security, at the Federal Employment Agency contributions paid for recipients of short-time working and unemployment benefits do not alleviate crisis-induced contribution shortfalls. Yet contributions for insolvency benefit payments rose sharply. At the start of the year, the legally stipulated contribution rate doubled to 0.12%. However, it is still far below the peak experienced during the financial and economic crisis (2010: 0.41%).

Steep rise in spending, chiefly due to short-time work

Spending has doubled vis-à-vis the first quarter of 2020 (+€9 billion). Payments for unemployment benefit were up by roughly one-third (+€1½ billion). Spending on short-time working benefits amounted to €8 billion (2020: €½ billion). Social contributions paid by the Federal Employment Agency on behalf of enterprises as an exceptional crisis measure accounted for around €3 billion of this. Insolvency benefits, which had stood at a low level in the first quarter, fell a little further still. However, given the suspension of the obligation to file for insolv-

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

14 Excluding the civil servants' pension fund. Transfers to the fund are thus recorded as expenditure here, lowering the core budget balance. These transfers have been suspended from the second quarter of 2020 until the end of 2021 because of the coronavirus crisis. Transfers amounted to €170 million one year earlier.

ency until the end of April, there were crisis-induced exceptions in this area.

Deficit for year as a whole much higher than planned; financing should subsequently be possible without government support

The Federal Employment Agency's budget plan envisages a deficit of €9 billion in its core budget for the current year as a whole. Financing is to come from the reserves of €6 billion remaining at the end of 2020 and an additional central government grant of €3 billion. With the first quarter of the year at an end, it is already clear that the Federal Employment Agency will require additional liquidity loans from central government. The finances of the former are likely to greatly improve once measures to contain the pandemic gradually come to an end. However, given the significant strains that are on the cards for the first half of the year, the deficit could be roughly twice as high as currently envisaged. According to current forecasts, the economic situation is set to continue improving considerably next year. Additional crisis assistance funds from central government may no longer be required.

Public finances in the euro area and the European Union

Developments in the euro area

Deficit ratio rose to over 7% in 2020 …

Last year, the deficit ratio in the euro area shot up by 6½ pps to 7.2% (see the table on p. 75), in large part due to the sharp economic downturn. Fiscal policy made a substantial contribution to macroeconomic stabilisation via the operation of automatic stabilisers. In addition, extensive measures were taken to mitigate the fallout from the pandemic. Not least for these reasons, the cyclically adjusted deficit ratio increased by 2½ pps. The debt-to-GDP ratio rose by over 14 pps to 100%.[15] Besides the high deficit, the decreased GDP in the ratio's denominator also accounted for this. Additionally, fiscal measures, which are reflected in the debt level but not in the deficit, had a role to play (2¼ pps). These include, for example, government or government-mandated assistance loans to enterprises.

… and is likely to climb further in 2021

The European Commission expects the euro area deficit ratio to climb further (to 8%) in the current year. Sizeable additional fiscal stabilisation measures will account for 2½ pps, while solid economic growth will curb the increase in the deficit through the operation of automatic stabilisers. The debt-to-GDP ratio is projected to rise by 2½ pps to 102½% this year. In the denominator, the expansion of economic activity will counteract the impact of the high deficit, pushing down the ratio.

Significant rebound in 2022

Government finances are then expected to rebound significantly in 2022. The unwinding and expiry of sizeable temporary stabilisation measures will bring the deficit down by 2½ pps. The economy will also continue to recover rapidly, which will take pressure off general government budgets. As a result, the deficit ratio will decline by just over 4 pps to 3.8%, which is still just over 3 pps higher than it was prior to the crisis (in 2019). According to data from the Commission, however, coronavirus crisis relief measures are still factored into the forecast, possibly to the tune of around 1% of GDP.[16] Adjusted for these measures, the structural deficit ratio will be around 1½% pps higher in 2022 than in 2019.[17] The debt-to-GDP ratio will see a moderate decrease of 1¾ pps in 2022. However, that still leaves it at over 100%, and 15 pps higher than it was before the pandemic.

Deficit ratio grew considerably in all countries last year …

The balances of individual euro area countries varied widely prior to the crisis. For example, Luxembourg and the Netherlands recorded significant surpluses in 2019 (+2.4% and +1.8% of

15 Here and in the remainder of the article, the figures referred to are those published by the European Commission in its most recent forecast. It publishes euro area aggregates for general government debt on a non-consolidated basis, i.e. not corrected for intergovernmental loans. See European Commission (2021).

16 The European Commission calculates these at 1% of GDP for the European Union as a whole but provides no information for the euro area.

17 The structural deficit ratio is one of the indicators that is relevant for the fiscal rules. It is calculated by taking the unadjusted deficit and subtracting the influence of the economic cycle and the effects of temporary measures. As defined by the Commission, the latter played no major role for the most part during the period under review.

Public finances in euro area countries

European Commission Spring Economic Forecast, May 2021

Country	General government balance as a percentage of GDP			General government gross debt as a percentage of GDP			Structural budget balance as a percentage of potential GDP		
	2020	2021	2022	2020	2021	2022	2020	2021	2022
Austria	– 8.9	– 7.6	– 3.0	83.9	87.2	85.0	– 5.7	– 5.8	– 2.9
Belgium	– 9.4	– 7.6	– 4.9	114.1	115.3	115.5	– 5.6	– 5.8	– 4.4
Cyprus	– 5.7	– 5.1	– 2.0	118.2	112.2	106.6	– 4.7	– 4.7	– 2.4
Estonia	– 4.9	– 5.6	– 3.3	18.2	21.3	24.0	– 2.8	– 4.2	– 2.1
Finland	– 5.4	– 4.6	– 2.1	69.2	71.0	70.1	– 3.4	– 3.3	– 1.5
France	– 9.2	– 8.5	– 4.7	115.7	117.4	116.4	– 4.7	– 6.7	– 4.7
Germany	– 4.2	– 7.5	– 2.5	69.8	73.1	72.2	– 1.8	– 6.2	– 2.5
Greece	– 9.7	– 10.0	– 3.2	205.6	208.8	201.5	– 4.7	– 6.6	– 2.2
Ireland	– 5.0	– 5.0	– 2.9	59.5	61.4	59.7	– 4.6	– 4.7	– 2.9
Italy	– 9.5	– 11.7	– 5.8	155.8	159.8	156.6	– 4.9	– 9.3	– 5.1
Latvia	– 4.5	– 7.3	– 2.0	43.5	47.3	46.4	– 3.3	– 6.2	– 1.9
Lithuania	– 7.4	– 8.2	– 6.0	47.3	51.9	54.1	– 6.7	– 7.0	– 5.0
Luxembourg	– 4.1	– 0.3	– 0.1	24.9	27.0	26.8	– 1.9	1.1	1.1
Malta	– 10.1	– 11.8	– 5.5	54.3	64.7	65.5	– 7.5	– 9.7	– 4.5
Netherlands	– 4.3	– 5.0	– 1.8	54.5	58.0	56.8	– 2.0	– 3.4	– 1.7
Portugal	– 5.7	– 4.7	– 3.4	133.6	127.2	122.3	– 2.0	– 3.2	– 3.2
Slovakia	– 6.2	– 6.5	– 4.1	60.6	59.5	59.0	– 4.7	– 6.0	– 4.4
Slovenia	– 8.4	– 8.5	– 4.7	80.8	79.0	76.7	– 6.7	– 7.7	– 4.7
Spain	– 11.0	– 7.6	– 5.2	120.0	119.6	116.9	– 4.2	– 4.9	– 5.2
Euro area	– 7.2	– 8.0	– 3.8	100.0	102.4	100.8	– 3.6	– 6.2	– 3.6

Source: European Commission (AMECO).

Deutsche Bundesbank

GDP, respectively), whereas Spain and France reported marked deficits (around -3% in each case). Balances then took a significant turn for the worse in all euro area countries last year. In many countries, the magnitude of the deficit-increasing measures was greater than the negative influence of the economic cycle. As a result, deficit ratios stood at between 4% (Luxembourg) and 11% (Spain). Debt-to-GDP ratios rose the most in those countries that already had high levels of general government debt.[18] At over 200%, the debt ratio in Greece was the highest, followed by those of Italy (over 150%) and Portugal (over 130%). In Belgium, Spain, France and Cyprus, too, debt had at that point risen to levels exceeding annual GDP.

… and is likely to also rise in around half of countries this year

The European Commission expects around half of countries to see a further increase in their deficit ratios this year – at 3 pps, Germany will see the greatest increase. The highest ratios, around 12%, are then expected for Italy and Malta. On balance, additional (deficit-increasing) measures will be adopted in almost all countries. However, this will be outweighed by the positive influence of the economic cycle in a number of countries, meaning that their deficit ratios will nevertheless decrease.

Shrinking deficits in all countries in 2022

All Member States' deficit ratios are set to shrink next year. A continued economic upswing and the expiry of numerous stabilisation measures are expected in nearly all countries. At this point, 11 out of 19 countries will then have a deficit ratio of below or close to 3% again. By contrast, Member States such as the high-debt countries of Belgium, Spain, France and Italy will still have ratios of around 5%. On the back of favourable financing with very low interest rates, nearly all countries will benefit from shrinking interest expenditure ratios. Des-

18 The way in which an identical GDP decrease (in the denominator) pushes up the ratio more for higher debt ratios than for lower debt ratios can also be observed here.

pite the significant increase in debt, interest expenditure in relation to GDP will be ½ pp lower than in 2019 in some countries – particularly high-debt countries. Based on the Commission's forecast, most countries' debt-to-GDP ratios will shrink next year. They will decrease most sharply in Greece, Cyprus and Portugal. However, they will still remain markedly over 100% in these countries as well as in Belgium, Spain, France and Italy. By contrast, they will stay below 60% in seven countries.

Detailed information on NGEU important for fiscal analysis

Eurostat and Commission should provide complete information about EU level

The Statistical Office of the European Communities (Eurostat) and the European Commission provide key information on government finances. This serves as an essential foundation for analysing fiscal policy in the European Union. Data on deficit and debt levels for past years and on projected changes are especially important. The sizeable amount of borrowing to finance the EU budget and, in particular, to finance the grants to the Member States have given rise to an entirely new fiscal instrument. For the purposes of proper fiscal analysis, it is crucial that the payment flows in connection with this are made transparent in both actual and projected figures.[19] Looking at the information provided by the Commission to date, this is not the case. The extent to which Eurostat will publish corresponding data for budget outcomes in future is currently unclear. It would be a point of criticism if government sector data at the EU level were not recorded according to national accounts standards (i.e. in the same way as the national indicators).

Deficits at EU level for first time due to coronavirus aid

Due to the European Union's COVID-19 recovery package, the EU level is running sizeable deficits for the first time. These stem from the European Union incurring NGEU debt through its provision of credit-financed grants to Member States. Unlike in the conventional EU budget, this EU expenditure is not matched by EU revenue in the same year.

Fiscal indicators for EU aggregate only reflect NGEU as deficit-reducing revenue for Member States

The European Commission appears to have incorporated the expected grants for 2021 and 2022 into its projected figures for Member States' government finances. Taken in isolation, they will reduce the Member States' deficits in these years. However, the Commission does not record the inversely associated deficits at the EU level; nor does it factor these into the EU or euro area deficit aggregates. As a result, the aggregates are not depicted in full. Based on rough calculations, a deficit of just over ½% of GDP should actually be factored in for the EU level in 2021 and 2022, respectively.[20]

EU debt likewise omitted

Debt at the EU level is likewise neither covered by the Commission's forecast nor factored into the EU and euro area aggregates for the debt-to-GDP ratio. In line with deficits, EU debt arising from NGEU grants is set to increase by just over ½% of GDP annually. Furthermore, the European Union is potentially taking on debt in order to supply countries with concessional NGEU loans. The Commission does not specify what assumptions it has made regarding these in its forecast, either. Rough calculations put EU debt at approximately 1% of GDP in 2020.[21] It could increase steadily to reach around 6% of GDP by 2026.

Comprehensive fiscal analysis for Member States requires additional information on EU level

It is important that additional data be made available not only for the EU aggregate, but also to be able to properly and comprehensively analyse the government finances of the individual Member States. Required data include the aforementioned data for deficits and debt at the EU level, but also information on payment flows between the European Union and the Member States.

19 See Deutsche Bundesbank (2020c).
20 With the exception of one graph (see footnote 26), the Commission merely states that it has factored in €140 billion in grants from the Recovery and Resilience Facility (RRF) over the forecast horizon (2021 and 2022). This amount is 40% of the total RRF financing that it assumes will be spent, with the remaining RRF grants being allocated between 2023 and 2026. It provides no breakdown by country, nor is information on other NGEU grants supplied.
21 It is assumed here that NGEU loans were also taken up in full. In addition, the calculations include EU debt for assistance loans from the SURE programme and older debt (excluding ESM).

Additional indicators for Member States important for analysis

With this additional information about the EU level, it would be possible to expand on individual Member States' regular disclosures on their government finances. This information could be used to provide a more comprehensive picture of the impact of fiscal policy decisions on Member States, amongst other things. After all, European debt is very similar to national debt, and it will need to be serviced by the same group of taxpayers as national debt. However, the usual national indicators do not capture the burden arising from European debt. For this reason, deficits and debts at the EU level should be allocated to individual countries for analytical and information purposes. EU deficits and EU debt should be taken into account in future, especially in the fiscal rules. If not, the purpose of these rules, which have so far been purely national in scope, will be at least partially negated, becoming increasingly ineffective as more debt is shifted from the national level to the European level (see pp. 69 f. for information on how EU debt is accounted for in the German debt brake).

Allocation of deficits and debt according to GNI share

For the additional indicators, it would seem appropriate to allocate EU deficits and EU debt to countries according to their share of EU gross national income (GNI). In principle, this share reflects a country's contribution to the EU budget, out of which EU debt will be serviced in future. Based on the above-mentioned rough calculations of EU deficits, ½ pp would thus be allocated to the deficit ratios of all EU countries over the forecast horizon in 2021 and 2022, respectively (see p. 76). EU debt for grants would result in the debt-to-GDP ratios of all countries being ½ pp higher in 2021, and just over 1 pp higher in 2022, than reported in the Commission's forecast.[22]

Adjustments over time possible

Both this allocation key and allocation as a whole have been criticised. One objection is that countries' GNI shares may shift before the debt is finally repaid. To date, however, they have been rather stable over time. In addition, the relative changes could be taken into account by making regular, commensurate adjustments to the allocation key.[23] Allocation would also have to be adjusted if the countries' shares of financing in the EU budget were to change significantly. This could happen if, for instance, new European taxes (or levies) were introduced. The load could be spread across the Member States according to a key based on something other than GNI share. However, some manner of allocation is nevertheless necessary as the financial burden would still rest on national debtors' shoulders, and national fiscal policymakers' scope for levying taxes would remain limited as a result.

Fiscal stance should also be measured more accurately

NGEU grants also need to be handled in a particular manner when analysing the fiscal stance. This is interpreted as, inter alia, the impact of fiscal policy on macroeconomic outcomes. Changes in the cyclically adjusted primary deficit ratio (as defined in the national accounts)[24] are often taken as an indicator of this. This is the part of the change in the deficit that is not the result of the cyclical component or interest expenditure. If this ratio rises, the fiscal stance is described as expansionary – government activity is supporting economic activity. In order for this indicator to retain its informative value, it would need to be adjusted for financial flows with the European Union. This means that it would be necessary to correct the national ratios for NGEU grants received, as this NGEU revenue does not have any restrictive effect on a Member State's national economic activity. Unlike in the case of most other forms of revenue, such as taxes, no domestic resources are withdrawn by general government. Instead, NGEU revenue flows in from abroad (from the

22 As the Commission does not provide any information on assistance loans, their inclusion in debt-to-GDP ratios is not discussed here. Their treatment could deviate from that of grant-related debt, as the countries receiving assistance loans include these in their national debt.
23 A national debt instrument linked to a country's GDP share of EU GDP would also be treated this way. An instrument of this kind does not currently exist. However, comparable debt instruments that are dependent on economic developments already exist and are part of the debt ratio, e.g. in the form of inflation-linked bonds.
24 This definition does not include the allocation of EU deficits and debt to the Member States described above. The fiscal stance indicator should also omit this.

credit-financed EU off-budget entity). Not adjusting for this, the fiscal stance would be assessed as too restrictive in the case of rising NGEU revenue. For countries receiving large NGEU grants, this can make a significant difference to the analysis. While the European Commission has not disclosed any detailed data on this, it notes that, for Spain in 2021 and 2022, NGEU revenue totalling around 3% of GDP is included in the forecast.[25] Of this, inflows are expected to amount to just over 1% of GDP in 2021. Spain is thus adopting an expansionary fiscal stance this year, whereas the indicator not adjusted for NGEU revenue indicates a restrictive fiscal stance (+¾ pp).[26]

No compelling case for general escape clause in 2022 as things stand today, but decision at a later date based on a more certain outlook prudent

General escape clause provides room for manoeuvre during crisis

Government measures have been a major factor in addressing this exceptional crisis. The high deficit and debt ratios that these are bringing about do not contravene European fiscal rules. Activation of the general escape clause suspended the rules of the Stability and Growth Pact (SGP) for 2020. The suspension of these rules was extended in October 2020 so that they would not be reimposed this year, either.

In March, Commission recommended continued application of clause in 2022

At the start of March 2021, the Commission proposed already deciding on the continued application of the general escape clause in 2022 in June 2021. In the Commission's view, the decision should be made following an overall assessment of the state of the economy by the Council, particularly of the real GDP level of the European Union and the euro area in 2022 compared with pre-crisis levels. At that time, the Commission concluded that the general escape clause should remain in place in 2022.

More favourable economic development expected

The Commission revised its expectations upwards in its latest forecast. Real GDP is set to return to the level recorded in the final quarter of 2019 in the fourth quarter of 2021 already, and to exceed it from the first quarter of 2022. Viewed from this perspective, one apparently essential reason in the view of the Commission for the continued application of the general escape clause is nullified. Another argument against continued application is that the Commission is forecasting strong growth overall for 2022. The EU output gap is projected to narrow in 2022, shrinking by 2.7 pps compared with 2021, and production capacity is expected to be more or less fully utilised on an annual average (output gap: -0.4%). While the assessment of this unobservable indicator is subject to relative uncertainty and susceptible to revision, the macroeconomic forecast nevertheless shows that 2022 will not be a crisis year. It also shows that the fiscal policy envisaged will not hinder a strong economic upswing.

Compliance with rules would not place any strain on economic growth

Moreover, economic growth would likely not be impeded by the deactivation of the general escape clause in 2022. Under the SGP, Member States are generally required to lower their structural deficit by 0.5% of GDP per year until their medium-term budgetary objective (MTO) is achieved.[27] Depending on a country's specific situation, this target can be adjusted. For example, the level of correction required could be

25 The Commission has stated that around half of the total amount of €70 billion in RRF grants made available to Spain will be absorbed over the forecast horizon.

26 For other countries, the effect appears to be greater in 2022 than in 2021. The key factor here is the year-on-year change in NGEU grants. However, there is a lack of precise information about the time profile. The Commission only goes so far as to present expenditure and other costs (per country) financed by RRF grants, as incorporated into the forecast, in a graph. The level of other NGEU grants is neither depicted nor specified.

27 Compliance with the debt criterion (corrective arm) requires that the part of the debt ratio above the 60% threshold be reduced by an average of 1/20th per year. Violation of this rule has never resulted in an excessive deficit procedure (EDP) being launched. Even where debt ratios have been very high, non-compliance has so far been excused as long as a country has not significantly deviated from its adjustment path towards its MTO.

reduced in adverse economic times.[28] However, there is something to be said for an ambitious fiscal stance in an unfavourable fiscal situation when deficit and debt levels are far in excess of SGP limits.

Consolidation unnecessary in most cases

According to the Commission's forecast, almost all Member States will comply with the rules. Owing to the extensive measures taken in response to the coronavirus crisis, one particular point needs to be noted: in a departure from normal practice, the Commission has included these mostly temporary and crisis-related measures in the structural budget balance, meaning that they are increasing the structural deficit. This will thus improve automatically once said measures become less significant – as is largely expected in 2022. The resulting contraction of the structural deficit will not hinder economic growth. Instead, it will be possible to discontinue measures due, for example, to employment opportunities opening up again and enterprises resuming business. In line with this, the Commission expects a strong economic upswing in 2022, despite the structural deficit shrinking by around 2½ pps. The structural budget balances of 19 EU countries will go so far as to improve by significantly more than 0.5% of GDP. Improvement will amount to less than this in three countries (Denmark, Luxembourg, Portugal), with the structural deficit worsening slightly in only two countries (Spain, Croatia). However, 2022 will see both of these countries experience exceptionally strong economic growth and their output gaps close.

As things currently stand, no compelling case for general escape clause in 2022

All in all, as things currently stand – based on the Commission's forecast – deactivation of the general escape clause would not require a change in fiscal course in 2022 that could jeopardise economic growth.[29] In high-deficit countries, the necessary gradual process of consolidation would be accompanied by an EDP. This would involve closer monitoring, which, given very high deficit and debt levels, is by all means desirable.

Hold off on decision about general escape clause until autumn

The outlook heading into next year remains highly uncertain, though. With that in mind, it would make sense to hold off on making a decision about the general escape clause until autumn. At that point, it should be far easier to gauge the extent to which economic activity is returning to normal. Should the situation turn out to be significantly less favourable than currently expected, application of the general escape clause could be continued. If, on the other hand, there is no change in the current favourable forecast, the fiscal rules that normally apply ought to be reimposed.

28 Under the preventive arm, quantitative targets are set out in what is known as the matrix of requirements. Under the corrective arm (i.e. in an EDP, primarily when the 3% threshold is breached), it is possible, especially where correction deadlines span multiple years, to deviate in individual years from the minimum improvement of 0.5% of GDP. In other words, requirements can also become country-specific in this way. Where this happens, it should be kept in mind that the aim is to bring down high debt ratios rapidly.

29 For example, the Commission projects a ¾ pp decrease in Spain's cyclically adjusted primary balance in 2022. As this is calculated, the expansionary effect would largely disappear with consolidation of ½ pp. However, this fiscal stance indicator includes NGEU grants, which will be higher again in 2022 than in 2021 – although they have no restrictive effect. Corrected for this, even with a rule-compliant fiscal adjustment of 0.5 pp, a fiscal impulse to the economy of ¾ pp would remain (more precise information cannot be given, as no details are provided in the Commission's forecast).

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