

## Public finances\*

### General government budget

*2015 surplus slightly higher owing to drop-out of temporary burdens*

The public finance situation in Germany remained favourable last year, with the fiscal surplus rising slightly to 0.5% (2014: 0.3%) of gross domestic product (GDP), according to provisional data for 2015. This improvement reflects cyclical developments as well as temporary effects – primarily the dropout of burdens owing to tax-related court rulings that had impacted on the 2014 figures. By contrast, the structural surplus, which is adjusted for these factors, declined slightly and amounted to ½% of GDP (see the box on pages 62 and 63).<sup>1</sup> The revenue ratio was unchanged at 44½%. The considerable increase in tax revenue bolstered the ratio, while the Bundesbank's profit, amongst other things, fell. The expenditure ratio dropped to 44%, reflecting the favourable economic situation, the expiry of temporary effects and the decline in interest expenditure. In contrast to this, social benefits, in particular, increased considerably. According to (provisional) data, this rise was attributable only to a minor extent to the high numbers of incoming refugees, as the influx has not yet had a major impact on social benefits over the year as a whole and also affected other expenditure categories (especially other operating expenditure). Overall, marked increases in pension expenditure (partly on account of the 2014 pension benefits package) and in the areas of healthcare and long-term care were more significant.

*Declining debt ratio*

The debt ratio had fallen to 71.9% by the third quarter of 2015. Roughly two-thirds of the decrease compared with the end of 2014 (74.9%) was attributable to nominal GDP growth in the ratio's denominator. Aside from this, central and state government, in particular, have scaled back their gross debt. This was also aided – to a minor extent – by a further decline in the liabilities of government-owned bad banks.

This year, the surplus is likely to be eroded and the government budget might be more or less balanced. Although – from today's perspective – the cyclical trend remains positive and the interest expenditure ratio is likely to fall a little further, various fiscal policy measures will weigh on the balance (tax cuts and additional spending, *inter alia*, on infrastructure, education, research and the housing allowance). Moreover, expenditure related to the influx of refugees will also grow. This expenditure may have risen by ¼% of GDP in 2015 (compared with 2014) and could climb by another ¼% of GDP in 2016, although there is considerable uncertainty surrounding the estimates.<sup>2</sup> A further decline in the debt ratio looks to be on the cards.

*Contraction of surplus in 2016*

The massive influx of asylum seekers poses tough challenges for Germany. Thanks to the current favourable economic situation, however, there is sufficient scope within the government budgets to absorb the associated financial burdens without breaching the deficit ceilings. The longer-term effects on government budgets are still difficult to gauge, and their scale will also hinge significantly on policy decisions in other areas – for example, on integration measures in Germany, on the allocation of refugees throughout the European Union (EU) and on tackling the root causes of migration. Fiscal policymakers would be well advised

*Good starting position creates financial leeway in the short term, ...*

\* The section entitled "General government budget" concerns the national accounts and the Maastricht ratios. The subsequent more detailed reporting on the budgets of central, state and local government and of the social security funds is based on the figures as defined in the government's financial statistics (which are generally in line with the budget accounts).

<sup>1</sup> In terms of the level of the balance, temporary effects and cyclical influences were largely negligible in 2015, following pressure on the 2014 balance mainly from temporary burdens.

<sup>2</sup> See also Deutsche Bundesbank, The current influx of refugees – projected impact on the labour market and public finances, Monthly Report, December 2015, pp 24-28. Expenditure in this connection can only be partially identified. This is also the case in the provisional annual result for 2015, which is still based to a large extent on estimates.

## The structural development of German public finances – results of the disaggregated framework for 2015

According to provisional data, Germany's general government budget posted a moderate surplus of 0.5% of gross domestic product (GDP) in 2015.<sup>1</sup> The fiscal outturn thus improved slightly on the 2014 surplus of 0.3% of GDP. The "disaggregated framework" for analysing public finances<sup>2</sup> can separately identify and estimate, first, the role played by cyclical influences and specific temporary effects and, second, other effects – referred to here as structural changes – in the revenue and expenditure ratios and their major determinants. The main developments in 2015 are presented below.<sup>3</sup>

The improvement in the fiscal balance owed something not only to a slightly positive cyclical influence, but also to clearly delineated temporary one-off effects. While tax refunds resulting from court rulings had weighed significantly on Germany's general government budget in 2014, revenue from an auction of mobile phone frequencies provided a little budget relief in 2015.<sup>4</sup> Consequently, the structural surplus ratio (the ratio of the fiscal balance, adjusted for cyclical and temporary effects, to nominal trend GDP) deteriorated marginally. The level of the structural surplus was more or less equivalent to the unadjusted value.

The structural revenue ratio remained unchanged, with a 0.3 percentage point decrease in the ratio of non-tax receipts being offset by an increase in the structural tax and social contributions ratio. Non-tax receipts were pushed down *inter alia* by waning interest income and a smaller Bundesbank profit. Tax and social contributions were mainly affected by one-off developments (residual: +0.2 percentage point). For

instance, wage tax receipts and revenue from real estate transfer tax (recorded as a structural figure) rose more than the rate implied by the change in the underlying macroeconomic reference variables.

The unadjusted expenditure ratio fell by 0.3 percentage point in 2015, whereas the structural ratio rose slightly, chiefly because of the adjustment for the aforementioned temporary one-off factors. Interest expenditure fell again on the back of the beneficial funding terms and the reduction in the debt ratio.<sup>5</sup> The structural ratio of other expenditure (primary expenditure) went up by 0.3 percentage point overall. On balance, this increase was largely driven by significant increases in social payments, which were related to a rise in spending on statutory pensions and long-term care as well as government outlays on refugees, amongst other factors.

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1 As defined in the national accounts.

2 For a more detailed description of the framework, including the standardised method of determining the cyclical component used in the Eurosystem, see Deutsche Bundesbank, A disaggregated framework for analysing public finances: Germany's fiscal track record between 2000 and 2005, Monthly Report, March 2006, pp 61-76.

3 These results are subject to amendments arising from revisions to the national accounts figures or to estimates of the macroeconomic outlook.

4 Tax refunds owing to court rulings are recorded in the national accounts as government spending (capital transfers) at the time of the final ruling (accrual basis). Significant tax refunds were reported in 2014. Proceeds from the auction of mobile phone frequencies are recorded in the national accounts as sales of non-produced assets and hence as negative government spending. The amounts are recognised when the frequencies enter into effective use, which means that the total proceeds of €5.1 billion will be allocated to 2015 (€0.5 billion), 2017 (€3.8 billion), 2018 (€0.2 billion) and 2019 (€0.6 billion).

5 The change in the interest expenditure ratio for 2015 is not shown in disaggregated form as the debt ratio outturn is not yet available.

### Structural development\*

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

Item	2009	2010	2011	2012	2013	2014	2015	Total 2009 to 2015
Unadjusted fiscal balance <sup>1</sup>	-3.1	-1.0	3.3	0.9	0.0	0.4	0.2	0.7
Cyclical component <sup>1</sup>	-1.6	0.2	0.9	0.0	-0.5	0.0	0.1	-0.9
Temporary effects <sup>1</sup>	0.2	-1.0	1.1	-0.1	0.1	-0.3	0.3	0.3
Fiscal balance	-1.5	-0.3	1.3	0.9	0.4	0.6	-0.2	1.3
Interest payable	-0.2	-0.1	0.1	-0.2	-0.3	-0.2	-0.2	-1.2
Owing to change in average interest rate	-0.3	-0.3	-0.1	-0.2	-0.3	-0.1		-1.5
Owing to change in debt level	0.1	0.3	0.2	0.0	0.0	-0.1		0.3
Primary balance	-1.7	-0.4	1.4	0.7	0.1	0.4	-0.3	0.1
Revenue	-0.9	-0.2	1.2	0.1	0.0	0.2	0.0	0.4
Taxes and social contributions	-1.0	-0.4	0.8	0.2	0.1	0.2	0.3	0.1
Fiscal drag <sup>2</sup>	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.6
Decoupling of macroeconomic reference variables from GDP	-0.3	0.2	0.2	0.1	0.0	0.0	-0.1	0.2
Legislative changes	-0.3	-0.6	0.2	-0.1	-0.2	-0.1	0.0	-1.1
Residual	-0.6	0.0	0.2	0.2	0.2	0.1	0.2	0.4
of which profit-related taxes <sup>3</sup>	-0.6	0.2	0.2	0.3	0.1	0.0	0.0	0.3
Non-tax revenue <sup>4</sup>	0.2	0.2	0.4	-0.1	-0.1	0.1	-0.3	0.4
Primary expenditure	0.8	0.2	-0.2	-0.5	-0.1	-0.2	0.3	0.3
Social payments <sup>5</sup>	0.2	0.0	-0.3	-0.3	-0.2	0.2	0.4	0.1
Subsidies	0.3	-0.1	-0.1	-0.1	0.0	0.0	0.0	-0.1
Compensation of employees	0.1	0.1	0.0	-0.1	-0.1	0.0	-0.1	0.0
Intermediate consumption	0.2	0.2	0.1	0.1	0.0	0.0	0.0	0.6
Gross fixed capital formation	0.1	0.0	0.0	0.0	0.0	-0.1	-0.1	0.0
Other expenditure <sup>6</sup>	-0.2	0.1	0.1	-0.1	0.2	-0.3	0.0	-0.3
<i>Memo item</i>								
Pension expenditure <sup>7</sup>	-0.1	0.0	-0.1	-0.2	-0.3	0.0	0.1	-0.5
Healthcare expenditure <sup>8</sup>	0.2	0.1	0.0	0.0	0.2	0.2	0.0	0.7
Labour market expenditure <sup>9</sup>	0.1	-0.3	-0.3	-0.2	-0.1	-0.1	0.0	-0.8
Long-term care expenditure <sup>10</sup>	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2

\* The structural figures are derived by adjusting for cyclical influences and specific temporary effects. **1** Year-on-year change in the ratio to nominal GDP. **2** In this context, the term "fiscal drag" encompasses the overall revenue effect of bracket creep in income taxation and the impact of the fact that specific excise duties are largely independent of prices. **3** Assessed income tax, corporation tax, local business tax, investment income tax. **4** Other current transfers receivable, sales and total capital revenue. **5** Including other current transfers to households. **6** Other current transfers payable to corporations and the rest of the world, other net acquisitions of non-financial assets and capital transfers payable. **7** Spending by the statutory pension insurance scheme, on recipients of civil servant pensions as well as payments by the Post Office Pension Fund and the Federal Railways Fund. **8** Spending by the statutory health insurance scheme and assistance towards civil servants' healthcare costs. **9** Spending by the Federal Employment Agency (excluding the reintegration payment paid to central government from 2008 to 2013) and central government expenditure on unemployment welfare benefit (II) and on labour market reintegration measures. **10** Spending by the public long-term care insurance scheme.

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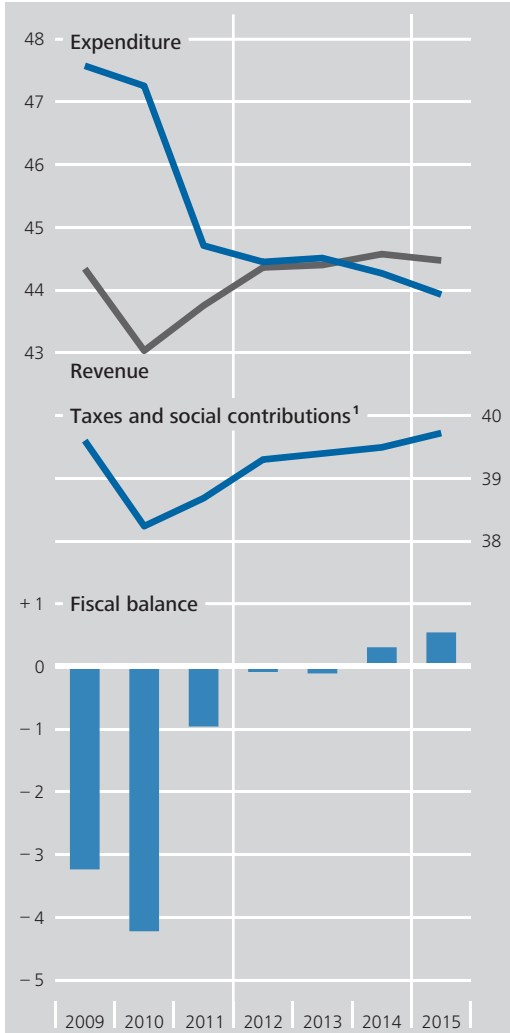
To sum up, Germany's public finances recorded a moderate surplus in 2015, both in unadjusted and structural terms. Distinctly increasing social payments meant that the structural balance worsened slightly overall, despite falling interest expenditure.

The structural fiscal ratio has significantly improved, by 1¼ percentage points, since the financial and economic crisis of 2008-09, which only manifestly impacted on the German general government account from 2009 onwards. On balance, the improvement is the result of a lower interest bur-

den, which is attributable to the decreased average rate of interest on government debt.

### General government fiscal ratios\*

As a percentage of GDP



\* As defined in the national accounts. <sup>1</sup> Taxes and social contributions plus customs duties.  
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... but renewed build-up of safety margins advisable going forward

to gradually restore the safety margins in future budgets after making use of them (in the form of moderate structural surpluses in the budget plans).<sup>3</sup> The pursuit of sound public finances and the implementation of important reforms are not contradictory aims. Rather, reliable compliance with budgetary rules forms a dependable basis for fiscal policy and creates an anchor of confidence. For Germany, the unfavourable demographic outlook poses a particular challenge. For this reason, too, it would make good sense to reduce the debt ratio to below the 60% ceiling before the associated burdens increase distinctly. In this way, public finances can also be made more robust against

future interest rate hikes and are better prepared for unexpected new challenges as well.

As a result of the additional spending on asylum seekers and the generally rather lax budget policy course, Germany's fiscal stance is expansionary in 2016. As things now stand, the national and EU deficit ceilings will be complied with nonetheless, albeit by a tighter margin than before. Calls for an additional fiscal stimulus in Germany are not convincing. Fiscal policy already tends to have a procyclical impact in the current rather favourable German economic setting. Further easing would appear risky, also in terms of compliance with the fiscal rules. An economic stimulus would be unlikely to help increase underlying growth in Germany or to tackle weak growth in other countries.

*Expansionary fiscal stance, but budget limits nonetheless maintained*

## Budgetary development of central, state and local government

### Tax revenue

Tax revenue<sup>4</sup> rose significantly in 2015 by 4½% (see the chart on page 65 and table on page 66) and was thus broadly in line with the November forecast made by the Working Party on Tax Revenue Forecasting. Receipts from income-related taxes climbed by an above-average 5½%. This was chiefly driven by the dynamic rise in wage tax receipts (+6½%), which was mainly bolstered by ongoing stable wage developments in conjunction with progressive taxation as well as the growing num-

*Clear tax revenue growth in 2015*

*Further dynamic increase in wage tax receipts*

<sup>3</sup> It would not be advisable to radically soften the fiscal policy stance, including in connection with the current influx of refugees. Caution thus appears necessary with regard to achieving large-scale future relief for public finances through additional tax and contribution receipts. Developments in this area are highly uncertain, and labour market integration is likely to be far more time-consuming and cost-intensive than for a targeted labour market-oriented inflow, for instance.

<sup>4</sup> Including EU shares in German tax revenue but excluding receipts from local government taxes, which are not yet known for the last quarter recorded.

ber of employees.<sup>5</sup> The retroactive increase in the basic income tax allowance will not have an impact on cash flows until the start of 2016. At 4%, growth in revenue from profit-related taxes was roughly on a par with the previous year's figure. Revenue from assessed income tax continued to rise dynamically, albeit somewhat less strongly than in previous years. Corporation tax revenue receded slightly, though at a relatively high level, while revenue from non-assessed taxes on earnings (mainly investment income tax on dividends) was somewhat higher than in 2014, probably because of larger profit distributions. Marked growth was also recorded in receipts from withholding tax, which – given the further drop in the interest rate level – could be attributable to higher income from tax on capital gains. Revenue from specific excise duties, which are largely volume-related, rose at a below-average rate (+1%). The slight decline in energy tax receipts was a contributing factor here. Income from turnover tax grew by 3½% and was thus broadly consistent with the relevant macroeconomic reference variables.

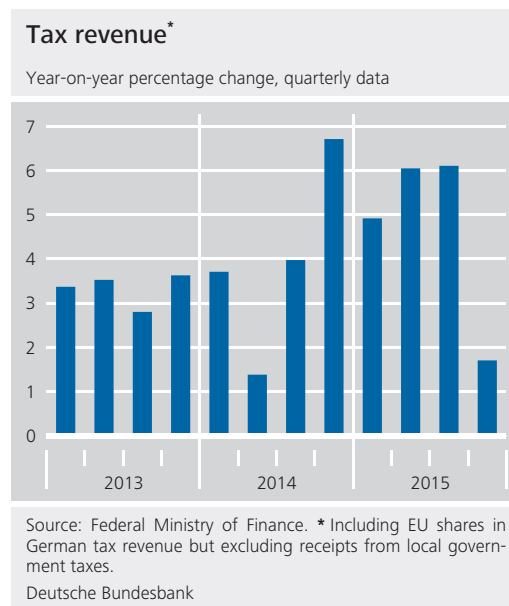
*Below-average rise in receipts from consumption-related taxes*

*Dampened revenue rise expected in 2016*

According to the official tax estimate of November 2015, growth in tax revenue (including local government taxes) is expected to be only moderate in 2016, at 2%. The underlying growth in the macroeconomic reference variables for tax revenue is forecast to be roughly the same as in 2015, but the impact of legislative changes is expected to reduce revenue growth distinctly. In particular, revenue shortfalls will be caused by income tax relief (raising the basic income tax allowance and the child tax allowance as well as a rightward shift in other tax brackets) and the increase in child benefit. Furthermore, extensive tax refunds are anticipated on account of court rulings, some of which were already made some time ago.<sup>6</sup>

## Central government budget

In 2015, the central government budget recorded a high surplus of almost €12 billion,



which was used in its entirety to fill up the new reserve for future additional expenditure related to refugees. In 2014, the budget had still posted a slight deficit (see the overview on pages 68 and 69 for an explanation of the various budget data, including the balance and net borrowing). Revenue rose considerably by 4½% (€15½ billion). In addition to a marked increase of €10½ billion in tax revenue, this was attributable, in particular, to proceeds of €4½ billion from the frequency auction<sup>7</sup> in spring 2015. Growth in expenditure was distinctly weaker (1%, or €3 billion). However, it should be noted that €4½ billion in capital had been injected into the European Stability Mechanism (ESM) in 2014 and interest expenditure continued its steep decline in 2015, falling by €5 billion. In this favourable setting, two supplementary

*High surplus in 2015 owing, not least, to proceeds from frequency auction and sharp fall in interest rates*

<sup>5</sup> This was additionally boosted by a disproportionately low increase in deduction amounts (child benefit and subsidies for supplementary private pension plans).

<sup>6</sup> These predominantly relate to rulings by the Federal Fiscal Court of 25 June 2014 (I R 33/09) and 30 July 2014 (I R 74/12) on section 40a of the Act on Asset Management Companies (Gesetz über Kapitalanlagegesellschaften) and STEKO (section 8b (3) of the Corporation Tax Act (Körperschaftsteuergesetz)) (see also Bundestags-Drucksache 18/5560) as well as the European Court of Justice ruling of 20 October 2011 on the taxation of dividends paid to EU/EEA companies (C-284/09). In the national accounts, however, the effect of the tax refunds is recognised at the time of the rulings in 2011 and 2014, increasing expenditure.

<sup>7</sup> The auction brought in a total of €5.1 billion. For some of the frequency bands, further payment dates are scheduled for the middle of this year and the next.

## Tax revenue

Type of tax	Year as a whole				Estimate for 2015 as a whole <sup>1,2,3</sup>	Q4			
	2014		2015			2014	2015		
	€ billion		Year-on-year change € billion	%	Year-on-year change %	€ billion		Year-on-year change € billion	%
Tax revenue, total <sup>2</sup>	593.0	620.3	+ 27.2	+ 4.6	+ 4.5	164.1	166.9	+ 2.8	+ 1.7
<i>of which</i>									
Wage tax	168.0	178.9	+ 10.9	+ 6.5	+ 6.6	47.6	49.8	+ 2.2	+ 4.6
Profit-related taxes <sup>4</sup>	90.9	94.4	+ 3.5	+ 3.8	+ 4.2	22.2	21.5	- 0.7	- 3.3
Assessed income tax	45.6	48.6	+ 3.0	+ 6.5	+ 6.7	11.8	12.5	+ 0.6	+ 5.4
Corporation tax	20.0	19.6	- 0.5	- 2.3	+ 4.6	5.1	3.8	- 1.2	- 23.9
Investment income tax <sup>5</sup>	25.2	26.2	+ 1.0	+ 3.8	- 0.4	5.3	5.2	- 0.2	- 3.2
Turnover taxes <sup>6</sup>	203.1	209.9	+ 6.8	+ 3.4	+ 3.1	52.3	54.1	+ 1.8	+ 3.5
Energy tax	39.8	39.6	- 0.2	- 0.4	+ 0.2	15.2	15.2	+ 0.0	+ 0.2
Tobacco tax	14.6	14.9	+ 0.3	+ 2.1	+ 0.2	4.7	5.0	+ 0.3	+ 7.3

Sources: Federal Ministry of Finance and Bundesbank calculations. **1** According to official tax estimate of November 2015. **2** Including EU shares in German tax revenue but excluding receipts from local government taxes. **3** Tax revenue including (still estimated) local government taxes was €12.2 billion above the November 2014 estimate, which formed the basis for the 2015 central government plan drawn up at the end of 2014. Excluding the effect of legislation passed since the estimate, the government projects that tax revenue would have been revised upwards by €13.2 billion. **4** Employee refunds, homebuyers' grant and investment grant deducted from revenue. **5** Withholding tax on interest income and capital gains, non-assessed taxes on earnings. **6** Turnover tax and import turnover tax.

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budgets were used to pay €3½ billion to the new Fund to promote municipal investment and €1½ billion to the Energy and climate fund for the advance financing of expenditure.

In a target/actual comparison, the surplus was still €7 billion higher than planned in the second supplementary budget of November 2015. Revenue exceeded the amount envisaged in the budget by €4½ billion. Tax receipts were €1½ billion higher than planned, which mainly corresponded to the last tax estimate's upward revision of tax revenue expectations, which was published shortly after the budget approval. Non-tax receipts also saw an increase of €3 billion, owing, not least, to a portion of the revenue from the frequency auction that had not been specified in the second supplementary budget, higher proceeds from financial transactions and refunds from the EU which were recorded as token entries in the budget.<sup>8</sup> On the expenditure side, the authorised volume was undershot by €2½ billion on balance.

Lower expenditure chiefly related to various transfer payments. In the area of military procurements, too, the budgeted amounts were not used in full. Minor relief was still provided, amongst other things, by interest and calls on guarantees.

For the structural result as defined in the debt brake rules, the Federal Ministry of Finance reported a surplus of 0.1% of GDP in its January Monthly Report (see the overview on pages 68 and 69 for information on how this is calculated). The assignment of the core budget's high surplus to the new refugee reserve was thus recognised in a different way to that used in the European budgetary surveillance rules which also have to be observed under the debt

*Reserve transaction recorded in a way that opens up leeway under debt brake*

<sup>8</sup> Token entries are budget items for revenue, possibly accompanied by spending authorisations, for which no amount is given. Spending is then permitted in line with the amounts actually received concerning the respective revenue items. In this case, however, the inflows were only matched by a limited volume of related additional expenditure on balance.

*Result is €7 billion better than planned in autumn 2015*

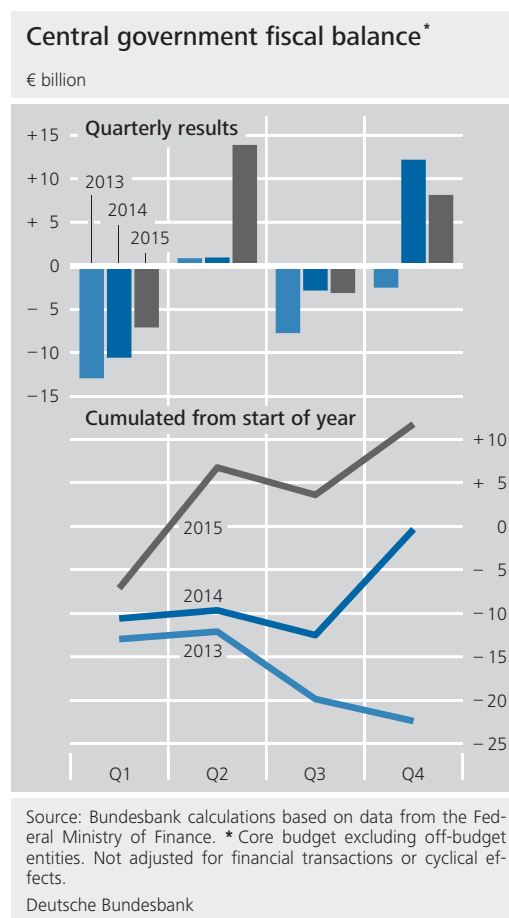
brake and moreover, for example, to that used for the Energy and climate fund, the surplus of which was likewise assigned to a reserve. Otherwise, a structural surplus ratio of 0.6% would even have been achieved. This procedure means that additional scope will be created when funds are withdrawn from the reserve in future.

*Underlying conditions for the 2016 budget somewhat improved, ...*

The central government budget for 2016 was adopted by the Bundestag at the end of November, again with no net borrowing. However, a €6 billion withdrawal from the refugee reserve was planned in order to cover additional expenditure on refugees. From the present perspective, it is fair to assume that at least some of the budget relief that materialised at the end of last year will continue. Although the more favourable result of last November's tax estimate was already incorporated into the final budget deliberations for 2016, very cautious calculations were made for the interest expenditure estimates, for instance. The funding advantages that have already been realised and the persistence of extremely favourable capital market conditions for central government suggest that the projected increase of €3 billion on the actual 2015 figure might not materialise. Moreover, it remains to be seen how much of the budgeted amounts for military equipment, which are distinctly higher than the previous year's result, is actually used. Finally, fairly cautious estimates have been made for guarantees and envisaged repayments from the EU, for example, in 2016 as well.

*... but considerable risks also exist*

There are also risks in other areas, however. For example, further perceptible strains are anticipated from aid payments for asylum seekers' countries of origin or their neighbouring countries. In addition, the planned growth in spending on unemployment benefit II (welfare-related benefit) of just 1½% – thus roughly in line with the increase in benefit payments at the start of the year – seems to be calculated tightly given the foreseeable rise in the number of recognised refugees eligible to claim. The central



government budget would be faced with burdens that are more difficult to overcome if the influx of refugees, which is experiencing a seasonal lull at present, does not subside substantially over the course of the year as apparently assumed. Another item not covered in the budget is compensation payments that may have to be made to operators of nuclear power plants that were shut down by government order, if the Federal Constitutional Court should so decide following the oral proceedings announced for March.

All in all, however, the planned deficit seems to be generously calculated, provided that the migration of asylum seekers develops as the government has so far anticipated and no court rulings that place a strain on the budget are issued. The balances of the relevant off-budget entities are also likely to be rather cautiously estimated. The ceiling for the structural funding gap under the debt brake of 0.35% of GDP to be applied for the first time is thus likely

*Overall compliance with debt brake as things stand*

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

€ billion							
Item	2014		2015			2016	
	Actual	Budget	Budget	Supple- mentary budget in May	Supple- mentary budget in November	Provisional actual	Budget
1 Balance	1 - 0.3	- 0.3	- 0.3	- 0.3	4.7	11.8	- 6.4
2 Coin seigniorage	0.3	0.3	0.3	0.3	0.3	0.4	0.3
3 Transfer to (-)/withdrawal from (+) reserves	-	-	-	-	- 5.0	- 12.1	6.1
4 Net borrowing (-)/repayment (+)	-	-	-	-	-	-	-
5 Balance of financial transactions	- 2.4	1.4	1.4	1.4	1.4	1.9	0.1
6 Cyclical component in the budget procedure	- 5.9	- 5.0	2 - 1.0	3 - 0.0	4 - 1.2		0.3
7 Balance of incorporated off-budget entities	- 0.8	-	-	-	-	4.5	- 5.4
Energy and climate fund	- 0.1	-	-	-	-	1.9	- 0.4
Flood assistance fund	- 0.7	-	-	-	-	- 0.9	- 3.5
Fund to promote municipal investment	-	-	-	-	-	3.5	- 1.5
8 Structural net borrowing (-)/ repayment (+)	7.5	3.6	- 0.4	- 1.4	3.8	-	- 5.8
9 Structural balance	7.2	3.3	- 0.7	3.3	15.6	-	- 11.9
10 Structural balance adjusted for updated estimate of potential output	4.0	.	.	.	.	16.1	- 10.9
11 Ceiling	- 26.6	- 18.6	- 18.6	- 18.6	- 18.6	- 18.6	- 10.2

1 The government's financial statistics (cash data) show a deficit for 2014 amounting to the level of coin seigniorage. By contrast, had there been no additional ad hoc transfers to the Investment and repayment fund at budget outturn, there would have been a slight surplus. 2 Simplified procedure applied: adjusted to the spring 2015 projection. 3 Simplified procedure applied: adjusted to the autumn 2015 projection. 4 Simplified procedure applied: adjusted to the national accounts figures published in mid-January 2016. This is roughly equivalent to the Bundesbank's current estimate of central government's cyclical component calculated using the disaggregated cyclical adjustment method.

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### 1 Balance

The financial balance is the difference between the core budget's revenue and expenditure as defined in the government's financial statistics (cash data).

### 2 Coin seigniorage

Coin seigniorage is the revenue generated by central government by issuing regular coins. It is one way of funding a deficit (and, in this respect, is a type of borrowing). Coin seigniorage increases Maastricht debt.

### 3 Transfers to and withdrawals from reserves

These constitute another way of funding the budget balance. Reserves are first formed from surpluses and can then subsequently be depleted. Reserve fluctuations have an impact on net borrowing but do not affect the balance in the government's financial statistics or the Maastricht deficit

(deficit in the national accounts). Changes in reserves ultimately correspond to the formation and depletion of financial assets and therefore resemble financial transactions in this respect. Unlike financial relationships with off-budget entities incorporated within the framework of the debt brake rules and financial transactions, they affect the reference variable used by the Federal Ministry of Finance for the debt brake (see 8). Reserve withdrawals to the benefit of central government's core budget were last recorded in 1975.

### 4 Net borrowing

This corresponds to revenue from borrowing less expenditure for repayments ( $4 = 1 + 2 + 3$ ). The term "balanced budget" denotes a budget with no net borrowing.

### 5 Balance of financial transactions

Revenue from the realisation of financial assets (loan repayments, disposal of partici-



pating interests, capital repayments) less expenditure on financial assets (granting of loans, acquisition of participating interests, capital injections). Financial transactions are excluded from the Maastricht deficit. In an apparent move to ensure that the national debt brake complies with European rules, a clause was inserted into the Basic Law (*Grundgesetz*) stating that financial transactions are to be factored out when calculating the ceiling for central government's structural funding gap (see 11). However, distinguishing these from non-financial transactions (eg capital injections without a market return, or dividends from capital reserves) is sometimes difficult in practice.

## 6 Cyclical component in the budget procedure

When calculating the ceiling for the structural funding gap under the debt brake, cyclical factors are to be factored out (Article 115 of the Basic Law; see 11). Federal Government essentially uses the European Commission's cyclical adjustment procedure, which is also applied under EU fiscal rules. While the calculation made when drawing up the budget is based on a fully updated estimate of potential output, a simplified procedure is subsequently used (including when drawing up supplementary budgets).<sup>1</sup> Here, the cyclical component from the Budget Act (*Haushaltsgesetz*) is adjusted for the estimated budgetary impact of the (expected) change in growth in nominal gross domestic product (GDP) between the point at which the budget was drawn up and the point at which the calculation is made.

## 7 Balance of incorporated off-budget entities

Under central government's debt brake, the balances (not the net borrowing) of the off-budget entities that were founded as from 2011 and are authorised to borrow are factored into the limit imposed by the ceiling (see 8). Also incorporated are entities that are pre-funded from the central government budget and whose surpluses when they are topped up are recognised in central government's structural result (eg Fund to promote municipal investment).

## 8 Structural net borrowing

Structural net borrowing ( $8 = 4 - 5 - 6 + 7$ ) is the Federal Ministry of Finance's reference variable for gauging compliance with central government's debt brake ceiling.

## 9 Structural balance

Within the scope of the government's financial statistics, the structural balance represents the reference variable that most closely approximates to the cyclically adjusted Maastricht deficit. Unlike in the case of structural net borrowing, coin seigniorage and changes in reserves are disregarded ( $9 = 8 - 2 - 3$ ).

## 10 Structural balance adjusted for updated estimate of potential output

Federal Government's latest estimate of potential output (last amended on 27 January 2016) is used in the cyclical adjustment procedure and therefore serves as the basis for a consistent picture of the cyclical position over the period under observation. Under the debt brake, the structural figures calculated using the simplified cyclical adjustment procedure are updated for the last time in the September of the year following the budget in question.

## 11 Ceiling

Under the debt brake, the ceiling for central government's structural funding gap from 2016 onwards is 0.35% of GDP in the year prior to that in which the budget is drawn up. A reduction path was defined for the years 2011 to 2015, the starting point for which was determined by the Federal Ministry of Finance based on an estimate from summer 2010.<sup>2</sup>

<sup>1</sup> See also Deutsche Bundesbank, The debt brake in Germany – key aspects and implementation, Monthly Report, October 2011, p 27.

<sup>2</sup> See also Deutsche Bundesbank (2011), op cit, pp 26-28.

to be complied with in the end, even without recognising the withdrawal from the reserve as income.

*Aim for surpluses in future – despite greater requirements posed by refugees and reform of federal structure – when adopting benchmark figures in March*

The Federal Cabinet's decisions on the benchmark figures for the 2017 budget and the new medium-term financial plan up to 2020 are due in March. According to the tax estimate of November 2015, the tax revenue estimates would actually only need to be reduced relatively moderately vis-à-vis the figures in the previous financial plan from the summer of 2015. Transfers of turnover tax to state government from 2017 onwards for the pledged case-based lump sum payments for asylum seekers had not been specified before the tax estimate (and have yet to be specified), however, and were therefore not included. Furthermore, additional burdens to be borne by central government as part of the reform of the federal structure would have to be included in the financial planning from 2020. If the migration of refugees continues at its previous strong level, greater strains could arise in particular for tax transfers to state government based on the number of cases, unemployment benefit II, as well as for central government's share of accommodation costs, which, as a general rule, are to be covered by local government. It will only be possible to reliably quantify the actual additional burdens at a later date, not least because of the uncertainty regarding future migration levels.<sup>9</sup> However, it appears advisable to gear budgetary policy in such a way that, given a baseline scenario deemed realistic from today's perspective in the budget plans, at least a slight structural surplus, and thus a certain safety margin below the upper limit set by the debt brake is realised again in the future.

*Central government's off-budget entities recorded high surplus in 2015 owing to advance payments by central government, ...*

Central government's off-budget entities (excluding bad banks and other entities that use commercial double-entry bookkeeping)<sup>10</sup> recorded a high surplus of €9 billion in 2015 compared with just over €4 billion in 2014. On balance, the rise is largely attributable to the pre-financing of the new Fund to promote municipal investment, which received a central

government grant totalling €3½ billion. Following a broadly balanced result in 2014, the Energy and climate fund ultimately recorded a surplus of almost €2 billion arising from central government grants. The Restructuring fund, which generated surpluses of €½ billion in previous years on account of its income from the bank levy, posted a result of +€1½ billion. With a surplus of almost €1 billion owing to repayments of previously granted capital aid, the Financial Market Stabilisation Fund (SoFFin) also closed the year more favourably after a broadly balanced result in 2014. Furthermore, the surplus achieved by the off-budget entities for provisions for civil servants' pensions was also up by €½ billion. On the flip side, the deficit of the Flood assistance fund set up in 2013 rose somewhat to just under €1 billion – particularly as a result of a (re)payment to central government, although it would appear that this amounted to only half of the €½ billion planned in the central government budget. The balance of the Investment and repayment fund, which was set up in 2009 to fund an economic stimulus package, deteriorated more sharply. An appropriation of €2 billion from the Bundesbank's profit in 2014 was followed by a transfer of only €½ billion arising from a closing entry in the central government budget at the start of 2015. After receiving a transfer of just over €½ billion from the central government budget in 2014, the Special provision fund for inflation-indexed Federal securities needed to make a

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<sup>9</sup> No precise figures on the net migration of refugees last year are available as yet either. Within the total of 1.1 million arrivals recorded in the system for the initial reporting of asylum seekers (EASY), some people have probably been counted twice and onward travellers are not systematically booked out. Only 0.44 million applications for asylum have been submitted to the Federal Office for Migration and Refugees, and reliable data concerning outstanding applications do not seem to be available. To ensure that the necessary goods and accommodation can be provided at an appropriate level and in the right place, it seems crucial that reliable data are made available as soon as possible. Orderly recording of arrivals would help to organise support and integration measures efficiently and also to distribute the expenses actually incurred amongst the government levels, as agreed.

<sup>10</sup> The new reserve is also not included in the off-budget entities as it is not an independent entity.

small repayment in 2015 owing to a fall in the applicable price index.

*... but deficit likely to follow in 2016*

An overall deficit, and thus a significantly less favourable result, is on the cards for 2016. After being pre-financed in 2015, the Fund to promote municipal investment is expected to have its first significant outflows this year. It is also foreseeable that the reserves built up by the Energy and climate fund in 2015 will gradually be depleted. Furthermore, the Flood assistance fund's deficit is likely to increase markedly. In addition to making higher repayments to central government, a rise in compensation payments is anticipated. Moreover, the deficit recorded by the Special provision fund for inflation-indexed Federal securities is set to increase substantially due to an upcoming repayment. In the case of the Restructuring fund, the transfer of receipts posted in the previous year to the new Single Bank Resolution Fund is likely to have a negative impact. If renewed relief is not provided through repayments of previously granted capital aid, SoFFin is likely to also be plunged back into deficit. The Investment and repayment fund is set to receive no transfer arising from profit generated by the Bundesbank in excess of the budget estimate or at budget outturn as, in these cases, a topping-up of the reserve for additional refugee-related spending is envisaged in the most recent budget laws. Only the civil servant pension pots might see a year-on-year improvement with somewhat higher surpluses.

## State government budgets<sup>11</sup>

*Higher surplus in 2015 despite deterioration in final quarter*

According to the monthly cash statistics, the surplus recorded by the state government core budgets in 2015 came to just under €3 billion and was thus still markedly up on the year (by €2 billion) despite a deterioration in the fourth quarter. Supported, in particular, by the significant growth in tax revenue (+6%, or €14½ billion), receipts rose by a total of just over 4½% (€15 billion). Following additional impetus in the last quarter (probably not least in connec-

tion with expenditure on refugees – responsibility for their initial reception lies at state government level), spending climbed by 4% (€13 billion) for 2015 as a whole. Strong growth was recorded, above all, for other operating expenditure (+12½%, or €3½ billion) and current transfers to local government (+9%, or €6 billion). All in all, investment was also up significantly (+4½%, or €1½ billion). By contrast, only a moderate increase was recorded for personnel expenditure (+2%, or €2½ billion),<sup>12</sup> while interest expenditure continued to fall sharply (-7½%, or just over €1 billion).

A certain level of deterioration in state government finances is expected for 2016, the main reason for this being anticipated additional expenditure on asylum seekers. It should also be borne in mind that the additional central government funds for state and local government approved in autumn 2015 to address this – taking the form of advance payments (via higher shares in turnover tax revenue), in particular – are to be transferred based on assumptions made at that time. Should the average time needed to make decisions on asylum applications be greater, or the influx of refugees be higher than was assumed last autumn, actual refugee numbers will not be taken into account until the final settlement is calculated in 2017. In this regard, the federal states are effectively providing financial assistance in advance in 2016 and are temporarily being further weighed down by payments over and above their agreed share of the costs – which also includes spending on school educational programmes. Furthermore, growth in tax revenue is likely to taper off markedly according to the latest tax estimate. Relief is expected to follow in the years to come, however, as persons who are granted refugee status are then entitled to

*Refugee-related additional spending causing financial deterioration in 2016, but relief likely to be provided by central government in 2017*

<sup>11</sup> The development of local government finances in the third quarter of 2015 was analysed in the short articles of the Bundesbank's January 2016 Monthly Report. These are the most recent data available.

<sup>12</sup> In the case of current staff, growth amounted to only 1% and was therefore actually less than the increase in negotiated pay rates, which was largely adopted for civil servants.

claim the means-tested basic allowance for job seekers (unemployment benefit II), which is financed by central government. But another important factor for state government budgets will be the speed at which, and extent to which, rejected asylum applicants are repatriated – an option to which, it would appear, relatively little recourse has been made to date. Responsibility for this lies at state government level; funding will not be provided by central government if applicants remain in Germany for a longer period of time after their applications have been rejected.

*Extension of budgetary recovery procedures for Bremen and Saarland envisaged*

There remains a wide gulf between the federal states in terms of their financial situation. Although the debt brake is not set to enter into force until 2020, the vast majority have already achieved at least a balanced (core) budget. At its meeting in December 2015, the Stability Council expected the budgetary recovery procedures launched for Berlin and Schleswig-Holstein in 2012 to be successfully completed this year. At the same time, however, it was deemed necessary to extend the budgetary recovery procedures for Bremen and Saarland, which are especially heavily indebted and still have high budget deficits, and implement additional consolidation measures over the coming years in order to ensure their compliance with the debt brake.

*Financial equalisation proposal made at the state government level offers no major improvements*

At the same time as the debt brake requirements enshrined in the Basic Law (*Grundgesetz*) enter fully into force at state government level, the financial equalisation system hitherto in place will expire. It would certainly be desirable for the requisite new rules on financial equalisation to be simpler and more transparent. Additionally, it appears to be worth considering reducing the degree of financial equalisation to a certain extent in order to take account of regional price differences, for instance, and set improved incentives to reinforce the financial and economic capacity of each federal state. Given this opportunity to adopt a further-reaching reform, it would be highly advisable to decisively strengthen the principle of respon-

sibility at the individual state government level, thereby expanding scope for action to comply with the debt brake, such as by means of limited, state-specific surcharges or discounts on income tax.<sup>13</sup> The reform proposal presented by the federal states in December 2015<sup>14</sup> presents very little prospect of improvement in this regard. The proposal to do away with the state government financial equalisation system currently in place and instead even out differences in financial capacity primarily via the distribution of turnover tax receipts would indeed constitute a certain degree of simplification. At the same time, however, the high degree of equalisation would essentially be maintained and new supplementary central government grants, some of which are not immediately clear-cut in economic terms, are envisaged. All in all, the incentives to reinforce financial capacity at the individual state government level therefore remain limited. In the upshot, all state governments are better off at the expense of central government. Above and beyond that, the federal states are also proposing higher, open-ended financial aid for budgetary recovery for Bremen and Saarland without placing conditions on these payments – conditions that are key to avoiding moral hazard. It is not least in terms of incentives for federal states to assume individual responsibility for their own budgetary policies that a critical view should also be taken of the proposal to introduce central/state government combined bonds with full central government liability in order to facilitate more favourable borrowing conditions for state government.

<sup>13</sup> For more information on this subject, see Deutsche Bundesbank, The reform of financial relations in the German federal system, Monthly Report, September 2014, pp 33-52.

<sup>14</sup> See the press release concerning the conference of the state premiers at the Bremen federal state office in Berlin, which was held on 3 December 2015.

## ■ Social security funds<sup>15</sup>

### Statutory pension insurance scheme

*Deficit in 2015 lower than expected*

According to provisional figures, the statutory pension insurance scheme recorded a deficit of almost €2 billion in 2015 following a surplus of just over €3 billion in the previous year. While a deficit had been expected as a result of the contribution rate cut and the full-year impact of the pension benefits package that came into effect in mid-2014 (in particular, the increase in the mothers' pension and the full pension without actuarial deductions from the age of 63), it was significantly lower than originally estimated when the contribution rate was cut from 18.9% to 18.7% (€4 billion). Consequently, the reserve came to 1.7 times the scheme's monthly expenditure at the end of 2015 and thus remained markedly higher than the regular upper limit of 1.5 times the scheme's monthly expenditure.

*Significant burdens arising from pension benefits package and contribution rate cut*

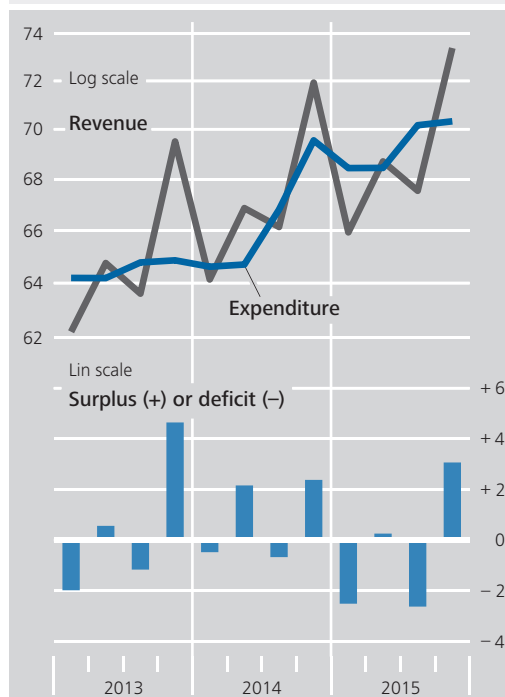
Rising by 2½% (€6½ billion), overall receipts climbed at a somewhat more subdued rate than in 2014. Owing to the cut in the contribution rate, growth in contribution receipts was pushed down to 3%. Adjusted for this, however, growth was 4% – more or less as sharp as in 2014 – thanks to favourable employment and wage developments. Central government grants were up by a total of 2%. At 4½% (€11½ billion), expenditure growth significantly outstripped that of receipts. Pension spending rose at a similarly high rate. First, this was driven by the mid-year pension increases (July 2015: 2.1% in western Germany and 2.5% in eastern Germany). Second, the benefit increases in connection with the pension benefits package continued to make themselves felt.

*Rising deficits on the cards*

This year, one particular factor that is likely to drive up spending is the pension increase at mid-year, which is expected to be very strong (over 4%). The massive rise in 2016 is chiefly attributable to robust wage increases, correcting the statistical special effect from the previ-

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

€ billion, quarterly data

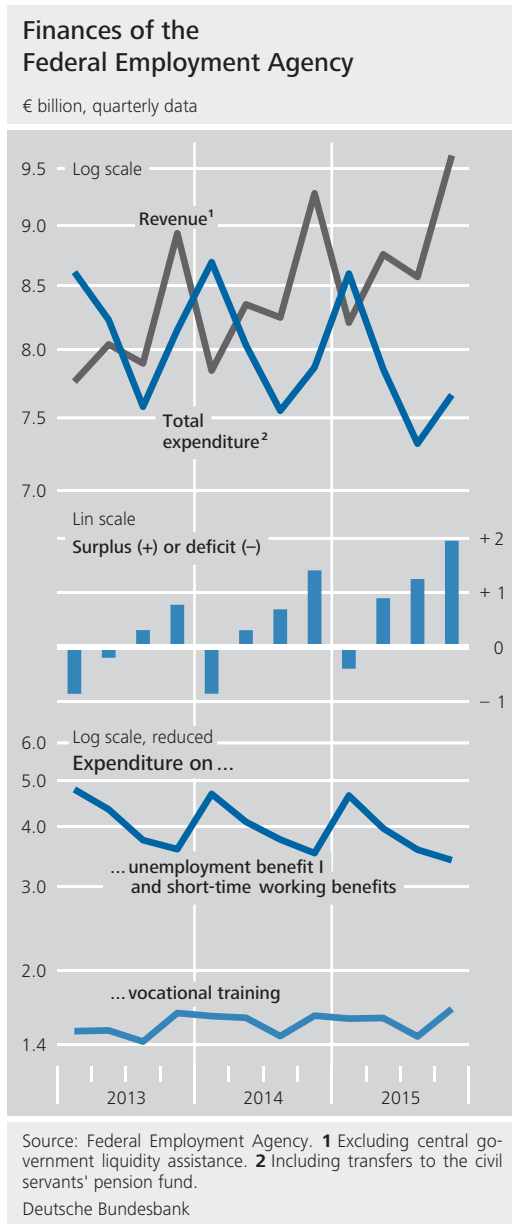


Source: German statutory pension insurance scheme (Deutsche Rentenversicherung Bund).  
 Deutsche Bundesbank

ous year (due to the revision of the national accounts) and pensions being pushed upwards due to the contribution rate cut at the start of 2015. Even so, the overall rate at which pension spending is rising could be somewhat lower than in 2015 owing to the waning impact of the pension benefits package,<sup>16</sup> meaning that the deficit increase would remain contained. In the light of the demographic lull coming to a gradual end and the number of persons entering retirement shooting upwards, the statutory pension insurance scheme looks set to remain in deficit in the years to come. The reserves will therefore continue to be depleted and, once they reach the lower limit of 0.2 times the scheme's monthly expenditure, it

<sup>15</sup> The financial development of the statutory health and public long-term care insurance schemes in the third quarter of 2015 was analysed in detail in the short articles of the Bundesbank's December 2015 Monthly Report. These are the most recent data available.

<sup>16</sup> The more likely scenario is that the number of persons taking early retirement will fall, causing the rate at which spending is rising to slow accordingly.



*Higher surplus in 2015 thanks to sharp rise in contribution receipts ...*

is likely that pressure to raise contribution rates will persist over the longer term.

## Federal Employment Agency

The surplus recorded by the Federal Employment Agency in 2015 totalled just over €3½ billion and was therefore up by €2 billion on the year.<sup>17</sup> By contrast, a surplus of only just under €½ billion was envisaged in the budget plan. Around €3 billion will be paid into the general reserve, a move that will raise its funds to €6½ billion, while the rest will be transferred to specific reserves (insolvency benefit and win-

ter compensation payments). The improvement is attributable, on the one hand, to a sharp revenue rise of just under 4½% (€1½ billion). Positive macroeconomic developments were reflected in growth in contribution receipts, which likewise amounted to just under 4½%, while a similarly steep increase overall was recorded for other revenue (particularly refunds of administrative costs by central government, the winter construction levy and insolvency benefit contributions).

On the other hand, spending recorded a year-on-year fall of just over 2% (just over €½ billion). The continued improvement in the labour market situation contributed to the significant decline in expenditure on unemployment benefit I (insurance-related benefit), which fell by 3½%. Benefits pursuant to the Phased Retirement Act (*Altersteilzeitgesetz*) fell particularly sharply (-38%) due to the phasing-out of subsidies from the Federal Employment Agency. Spending on active labour market policy measures remained virtually unchanged.

*... and lower spending*

The budget plan adopted in December 2015 envisages a surplus of just under €2 billion for 2016. This represents a marked deterioration compared with actual figures for 2015. As in previous years, spending on active labour market policy measures is expected to rise very sharply (by one-quarter to just over €8 billion). Just under €½ billion has been earmarked for temporary measures – that were already expanded in 2015 – to integrate refugees into the labour market, eg by offering language courses. However, actual figures in some areas may once again be better than the estimates in the budget plan. According to the planned figures, administrative spending will climb significantly (+8%, or €½ billion), which is largely attributable to support and placement services provided to refugees. For instance, staffing levels are to be further increased at job centres as it is expected that, as the number of asylum appli-

*Despite additional expenditure, surplus still planned for 2016*

<sup>17</sup> Including the Civil servants' pension fund, the surplus amounted to €4 billion.

cations being successfully processed rises, personnel requirements will intensify distinctly from around mid-2016 onwards since more staff will be needed to deal with those refugees who are then entitled to (means-tested) unemployment benefit II. The associated costs will, as a general rule, be refunded by central government as recourse cannot be made to in-

surance against temporary unemployment based on previous contribution payments. In order to preserve the contribution equivalence principle, it would be essential to ensure that the cost of further expanding measures to integrate refugees not eligible to claim insurance benefits into the labour market were covered primarily using general tax revenue.