

Public finances*

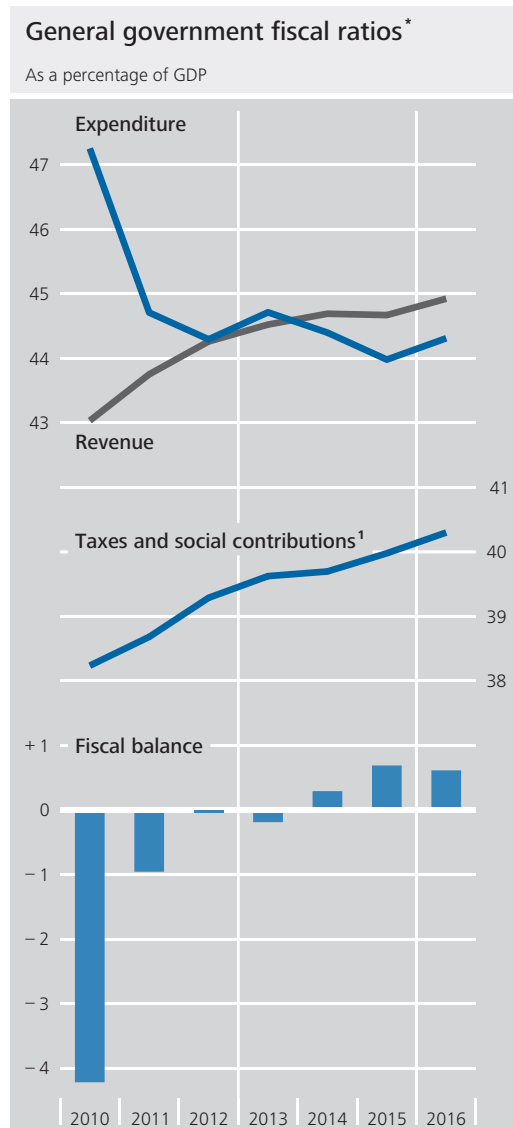
General government budget

2016 brought to a close with another marked surplus

On the back of continued very favourable conditions for public finances, Germany last year generated a third consecutive surplus. According to provisional data, the balance was virtually unchanged at 0.6% of gross domestic product (GDP). On the one hand, pressure on government budgets was eased by favourable cyclical developments and by interest expenditure being lower again. On the other hand, the underlying fiscal stance was expansionary,

meaning that the surplus shrank once adjusted for cyclical impacts and interest expenditure (see also pages 57 and 58). All in all, public finances benefited from significant revenue increases, not least from profit-related taxes. However, expenditure also rose fairly steeply in some cases, chiefly in relation to the provision of support for refugees, which rose considerably after immigration reached its peak in autumn 2015 and continued into last year – albeit at a significantly lower rate. This was compounded by substantial additional expenditure in areas such as pensions and healthcare. The debt ratio stood at 69.4% at the end of the third quarter of 2016, well below the level at the end of 2015 (71.2%).

Further fall in debt ratio



A similar surplus looks set to be recorded for the current year, and the debt ratio is expected to continue its marked downward trend. On the one hand, economic activity and continued drops in interest expenditure are likely to ease the strain on public coffers. On the other hand, the fiscal policy stance remains moderately expansionary. This is attributable to significant expenditure hikes caused, for instance, by the expansion of the benefits provided under the public long-term care insurance scheme, the sharp pension rise in mid-2016 and increased funding for childcare, infrastructure and the military.¹

Similar surplus likely in 2017 if debt ratio continues to drop

Thanks in part to the positive budgetary developments observed over recent years, it has already been possible to significantly reduce

Rapid scaling-back of debt ratio ...

* As defined in the national accounts. ¹ Taxes and social contributions plus customs duties.

* The section entitled "General government budget" relates to data from the national accounts and the Maastricht debt ratio. 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 finance statistics (which are generally in line with the budget accounts).

¹ In addition to uncertainties at the international level, German public finances are exposed to risks stemming, in particular, from court rulings in connection with the phasing-out of nuclear energy and in relation to the nuclear fuel tax.

The structural development of German public finances – results of the disaggregated framework for 2016

According to provisional data, Germany's general government budget posted a surplus once again in 2016.¹ At 0.6% of gross domestic product (GDP), this roughly matched the previous year's level (0.7% of GDP). The role played by cyclical influences and specific temporary effects is estimated using the "disaggregated framework" for analysing public finances.² Any further changes in the revenue and expenditure ratios are classified as structural, and their major determinants identified. The main results of this analysis for 2016 are presented below.³

The cyclical influence on the year-on-year change in the fiscal balance was slightly positive. After adjustment for cyclical and temporary effects (the latter of which were unremarkable last year), there was a slight deterioration in the structural fiscal balance in relation to trend GDP. The structural surplus was thus roughly the same as the unadjusted value.

The unadjusted revenue ratio increased by 0.3 percentage point; the structural change was similar. A significant increase in the tax and social contributions ratio contrasted with a slight decline in other revenue. The latter was depressed by lower interest income and the Bundesbank's reduced profit distribution.⁴ The increase in the tax and social contributions ratio was largely attributable to slight structural shifts within GDP which had a positive effect on its "revenue richness" and, in particular, surprisingly high growth in profit-related taxes. The development of entrepreneurial and investment income (used here as a macroeconomic reference variable) and the estimated impact of legislative changes would have led one to

expect a significantly more subdued development (residual: +0.2 percentage point). The ratio was increased slightly by fiscal drag,⁵ while it was reduced in net terms by legislative changes (income tax shortfalls on the one hand and higher additional contribution rates applied by the statutory health insurance institutions on the other).

The unadjusted expenditure ratio rose by 0.3 percentage point and thus slightly less than the structural ratio, which was primarily due to the GDP's denominator increasing slightly more strongly than its trend because of cyclical influences. Interest expenditure fell again, which was due first and foremost to the beneficial funding conditions.⁶ The structural ratio of other expenditure went up by 0.7 percentage point overall. This was chiefly because of significant net increases in social expenditure, which were predominantly linked to support for refugees and a rise in pension and healthcare expenditure. Despite subdued price developments, intermediate consumption also increased, apparently partly as a result of additional expend-

¹ As defined in the national accounts.

² For a more detailed description of the framework and 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 the macroeconomic outlook.

⁴ While the quota share was somewhat higher than in the previous year, the figure in the national accounts (after factoring out a release of provisions) saw a considerable decline.

⁵ In this context, the term "fiscal drag" encompasses the total (positive) revenue effect of income tax bracket creep and the (negative) impact of the fact that specific excise duties are largely independent of prices.

⁶ The breakdown of the change in interest expenditure for 2016 is not shown as the debt ratio for the year's end is not yet available.

Structural development*

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

Item	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total 2008 to 2016
Unadjusted fiscal balance ¹	-0.4	-3.1	-1.0	3.3	0.9	-0.2	0.5	0.4	-0.1	0.4
Cyclical component ¹	0.4	-1.7	0.2	0.8	0.0	-0.5	-0.1	0.1	0.2	-0.4
Temporary effects ¹	-0.3	0.2	-1.0	1.1	-0.1	0.1	-0.3	0.3	-0.0	-0.0
Fiscal balance	-0.4	-1.5	-0.3	1.3	1.0	0.2	0.8	0.0	-0.2	0.9
Interest payable ²	0.0	-0.2	-0.1	0.1	-0.2	-0.3	-0.2	-0.2	-0.2	-1.4
Owing to change in average interest rate	-0.0	-0.3	-0.3	-0.1	-0.2	-0.3	-0.1	-0.1	.	-1.6
Owing to change in debt level	0.0	0.1	0.3	0.2	-0.0	-0.0	-0.1	-0.1	.	0.3
Primary balance	-0.4	-1.7	-0.4	1.4	0.7	-0.1	0.6	-0.2	-0.4	-0.5
Revenue	0.2	-0.9	-0.2	1.2	0.0	0.2	0.3	0.0	0.3	1.1
Taxes and social contributions	0.2	-1.0	-0.4	0.8	0.2	0.3	0.2	0.3	0.4	0.8
Fiscal drag ³	0.0	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.7
Decoupling of macroeconomic reference variables from GDP	0.2	-0.3	0.2	0.2	0.0	-0.1	-0.0	-0.1	0.1	0.4
Legislative changes	-0.6	-0.3	-0.6	0.2	-0.1	-0.2	-0.1	0.0	-0.1	-1.7
Residual	0.5	-0.6	0.0	0.2	0.2	0.4	0.2	0.3	0.2	1.5
of which profit-related taxes ⁴	0.5	-0.6	0.2	0.2	0.3	0.1	0.0	0.1	0.2	1.0
Non-tax revenue ⁵	0.1	0.2	0.2	0.4	-0.1	-0.1	0.1	-0.3	-0.1	0.3
Primary expenditure	0.7	0.8	0.2	-0.2	-0.7	0.3	-0.3	0.2	0.7	1.6
Social payments ⁶	0.2	0.2	-0.0	-0.3	-0.2	0.1	0.1	0.3	0.5	0.9
Subsidies	-0.0	0.3	-0.1	-0.1	-0.1	0.0	-0.0	0.0	-0.0	-0.1
Compensation of employees	0.1	0.1	0.1	0.0	-0.1	-0.1	-0.0	-0.1	0.0	0.0
Intermediate consumption	0.2	0.2	0.2	0.1	-0.0	0.1	-0.1	0.0	0.2	0.9
Gross fixed capital formation	0.1	0.1	0.0	0.0	-0.1	-0.1	-0.1	0.0	0.1	0.2
Other expenditure ⁷	0.1	-0.2	0.0	0.1	-0.2	0.3	-0.2	0.0	-0.1	-0.2
<i>Memo item</i>										
Pension expenditure ⁸	-0.0	-0.1	0.0	-0.1	-0.2	-0.3	0.0	0.1	0.1	-0.4
Healthcare expenditure ⁹	0.2	0.2	0.1	0.0	-0.0	0.2	0.2	0.0	0.1	0.9
Labour market expenditure ¹⁰	0.1	0.1	-0.3	-0.3	-0.2	-0.1	-0.1	-0.0	0.0	-0.9
Long-term care expenditure ¹¹	0.0	0.0	0.0	-0.0	0.0	0.0	0.0	0.1	0.0	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** The breakdown for 2016 is not shown as the debt ratio for the year's end is not yet available. **3** 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. **4** Assessed income tax, corporation tax, local business tax, investment income tax. **5** Other current transfers receivable, sales and total capital revenue. **6** Including other current transfers to households. **7** Other current transfers, other net acquisitions of non-financial assets and capital transfers payable. **8** Spending by the statutory pension insurance scheme, spending on recipients of civil servant pensions as well as payments by the Post Office Pension Fund and the Federal Railways Fund. **9** Spending by the statutory health insurance scheme and assistance towards civil servants' healthcare costs. **10** 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. **11** Spending by the public long-term care insurance scheme.

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iture on refugees. By contrast, there was a decline in transfers to the EU budget, some of which were retroactively cut in accordance with the Own Resources Decision for the 2014-2020 financial framework, which was ratified last year.

To sum up, Germany's public finances recorded a notable surplus in 2016, both in unadjusted and structural terms. A positive cyclical trend and a further decrease in interest expenditure outweighed the expan-

sionary budgetary policy stance. In comparison with 2007, ie prior to the financial and economic crisis, the structural fiscal balance saw a marked improvement of around one percentage point. However, interest expenditure relief increased by half over that period, while the structural primary surplus ratio deteriorated by ½ percentage point.

the debt ratio from its record level of more than 80% in 2010. By 2020, it should be back below the 60% mark again for the first time since 2002. While any decline in the debt ratio reduces the interest burden, the key driver behind this reduction in recent years has been considerably more favourable funding costs, in particular. The average rate of interest on government debt fell from 4¼% in 2007 (pre-crisis) to 2% recently. In arithmetical terms, this resulted in interest savings of 1½% of GDP (€47 billion) in 2016 alone. However, the very low interest rate level at present belies the long-term burdens of government debt and paints an overly favourable picture of public finances.

... advisable not least in view of demographic trends

Rising social spending caused by demographics in Germany presents a convincing argument for rapidly scaling back the government debt ratio. The current planning, which envisages a structural surplus of ¼% to ½% of GDP, does not appear too ambitious. At the same time, structural policies that strengthen the forces of growth are desirable.² These also include investment to maintain good infrastructure; this could, however, be financed without having to increase debt, but it is chiefly a question of fiscal policy priorities.

Great importance of effective fiscal rules and consistent compliance with them at both the national ...

One factor that has likely been instrumental in reversing the debt trend of the previous decades is the introduction of the debt brake. Its purpose is to safeguard sound public finances and prevent the offloading of an ever greater share of the burden onto future generations. With this in mind, it is advisable to generally factor in moderate structural surpluses as safety margins so that some room for manoeuvre within the scope of normal budget limits can be retained in the event of unfavourable developments. This became apparent, by way of example, back when the budget was initially expected to suffer a significant deterioration in response to high numbers of incoming refugees. The available safety margin made it possible to first wait and see how this situation progressed – something that was difficult to gauge in advance. As things currently stand,

for the time being it may even be possible to dispense with measures that would leave a hole in the budget.

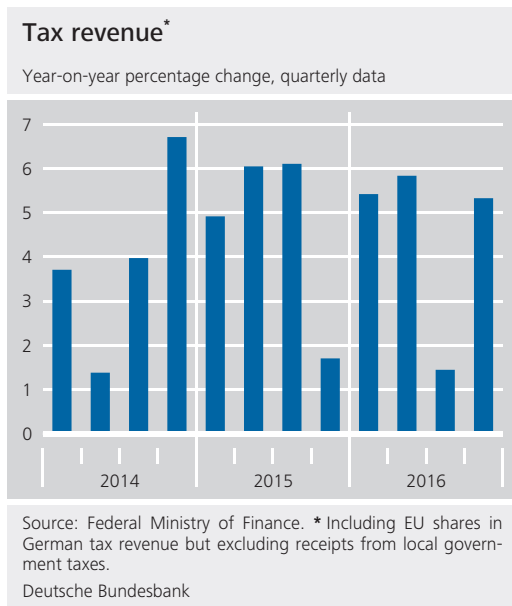
The European fiscal rules are continuing to lose their binding force, however. With its call back in autumn 2016 for a distinct loosening of the euro area's fiscal stance, the European Commission explicitly set aside the objective of sustainable public finances in favour of a coordinated economic fine-tuning approach.³ In the past, however, such attempts to steer the economy have met with little success due to a number of fundamental issues.⁴ The upswing in the euro area's economic activity has recently grown stronger, while unemployment has fallen markedly compared with its peak level during the crisis. According to the European Commission's assessment, the modest economic slack in the euro area as a whole will also be reduced next year even without any additional fiscal stimulus. However, the debt ratios in various member states are still very high. In many cases, there is no sign as yet of these ratios being rapidly reduced as a precaution against a resurgent interest rate level, amongst other reasons. In addition, the majority of medium-term budgetary objectives remain far from being met. In this respect, public finances in some countries still represent a major source of uncertainty. This is also partly reflected in risk premiums on government bond yields. Binding fiscal rules equally borne by all member states, not to mention a credible no-

... and European level

² See Deutsche Bundesbank, Public finances, Monthly Report, November 2016, pp 62-63.

³ See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Towards a positive fiscal stance for the euro area, Brussels, 16 November 2016, COM (2016) 727 final.

⁴ Using fiscal policy to actively stimulate the economy should be reserved for exceptional situations and requires that public finances have a solid foundation. For more information, see Deutsche Bundesbank, Fiscal policy, Monthly Report, October 2010, pp 81-82.



According to the official estimate of November 2016, an increase in tax revenue of around 4% (including local government taxes) is expected for 2017. In the meantime, however, amendments to tax legislation have been adopted that are putting the brakes on growth (chiefly the further cut in income taxes and the rise in child benefit). Moreover, the rate of change is significantly dampened by the fact that, for the most part, the envisaged burdens stemming from the aforementioned court rulings did not come to pass last year and will now largely make themselves felt this year.

Growth dampened in current year

bail-out clause, remain key prerequisites for a euro area focused on stability.⁵

Budgetary development of central, state and local government

Tax revenue

Tax revenue⁶ recorded a significant rise of 4½% in 2016 (see the above chart and the table on page 61). Compared with the official November 2016 forecast, figures have thus been revised upwards by €6 billion. This is largely due to the fact that – contrary to expectations – corporation tax refunds as a result of previous court rulings⁷ have, for the most part, not yet been paid out. All in all, revenue growth from profit-related taxes, in particular, remained strong. The sharp rise in wage tax receipts primarily reflects the increase in gross wages and salaries. The additional revenue generated by bracket creep in income taxation was somewhat more than offset by revenue shortfalls resulting from legislative changes (in particular, higher income tax allowances, a rightward shift in other income tax thresholds and the rise in child benefit). Turnover tax revenue likewise climbed markedly and was largely in line with its macro-economic reference variables.

Tax revenue up considerably in 2016

Central government budget

According to provisional figures, the central government budget recorded a surplus of €6 billion last year.⁸ However, this represented a marked year-on-year decline (2015: €12 billion), not least on account of spending in connection with refugee migration. Revenue growth remained subdued at 2%. Despite sizeable tax-share transfers to state government to offset part of its refugee-related expenditure, tax revenue was up somewhat more sharply at 3%. However, other revenue fell relative to values recorded in 2015, which had been elevated

Significant surplus once again for 2016 as a whole

⁵ For more information, see Deutsche Bundesbank, Approaches to strengthening the regulatory framework of European monetary union, Monthly Report, March 2015, pp 15-37; and Deutsche Bundesbank, Approaches to resolving sovereign debt crises in the euro area, Monthly Report, July 2016, pp 41-62.

⁶ Including transfers to the EU budget – which are deducted from German tax revenue – but excluding receipts from local government taxes, which are not yet known for the quarter under review.

⁷ Rulings by the Federal Fiscal Court of 25 June 2014 (IR 33/09) and of 30 July 2014 (IR 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). In the national accounts, such tax refunds are recorded as government spending (capital transfers) at the time of the final ruling rather than as reducing revenue at the time of payment.

⁸ According to the press release of the Federal Ministry of Finance of 12 January 2017. In the Federal Ministry of Finance's January 2017 Monthly Report, transfers not yet made to the fund to promote municipal investment and to state government in connection with the basic allowance for the elderly are not taken into account, resulting in a (cash) surplus of just over €10 billion being reported.

Tax revenue									
Type of tax	Year as a whole				Estimate for 2016 as a whole ^{1,2,3}	Q4			
	2015	2016	Year-on-year change			2015	2016	Year-on-year change	
	€ billion	€ billion	€ billion	%	%	€ billion	€ billion	€ billion	%
Tax revenue, total ²	620.3	648.3	+ 28.0	+ 4.5	+ 3.6	166.9	175.8	+ 8.9	+ 5.3
<i>of which</i>									
Wage tax	178.9	184.8	+ 5.9	+ 3.3	+ 3.0	49.8	52.3	+ 2.5	+ 4.9
Profit-related taxes ⁴	94.4	106.7	+ 12.3	+ 13.0	+ 7.4	21.5	25.8	+ 4.3	+ 20.1
Assessed income tax	48.6	53.8	+ 5.3	+ 10.8	+ 8.9	12.5	14.4	+ 2.0	+ 15.8
Corporation tax	19.6	27.4	+ 7.9	+ 40.1	+ 19.8	3.8	6.1	+ 2.3	+ 59.6
Investment income tax ⁵	26.2	25.4	- 0.8	- 3.1	- 4.5	5.2	5.2	+ 0.1	+ 1.3
Turnover taxes ⁶	209.9	217.1	+ 7.2	+ 3.4	+ 3.5	54.1	56.1	+ 2.0	+ 3.6
Energy tax	39.6	40.1	+ 0.5	+ 1.3	+ 1.0	15.2	15.5	+ 0.2	+ 1.6
Tobacco tax	14.9	14.2	- 0.7	- 4.9	- 2.5	5.0	4.3	- 0.7	- 14.3

Sources: Federal Ministry of Finance and Bundesbank calculations. **1** According to official tax estimate of November 2016. **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 €15 billion above the November 2015 estimate, which formed the basis for the 2016 central government plan drawn up at the end of 2015. Amendments made to tax legislation since that time played virtually no role in this revision. **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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by proceeds from the frequency auction. At 4%, the rise in spending was higher. Although interest expenditure was down by €3½ billion, this was significantly outweighed by additional burdens in the form of higher transfers (also due to the discretionary shortfall of €2½ billion in the transfer to the health fund coming to an end), investment and other operating expenditure.

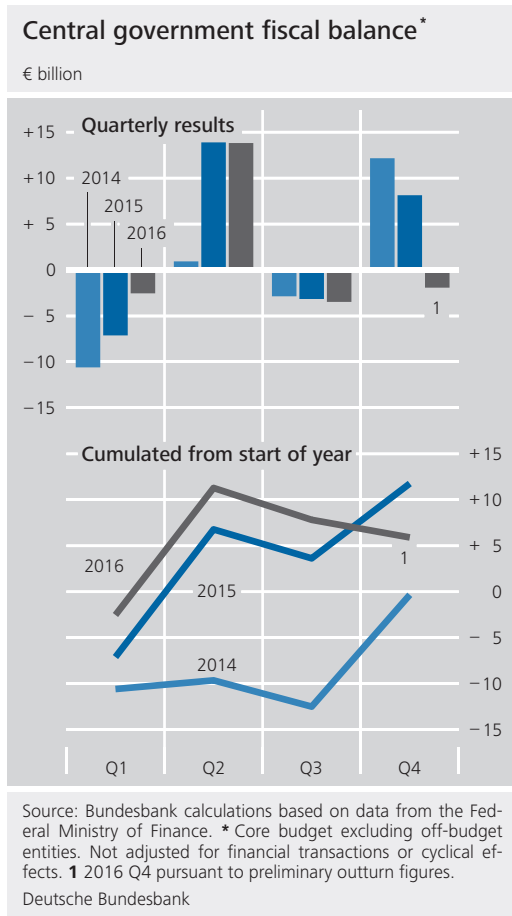
lower than the amount envisaged in the budget. At almost €3 billion, interest expenditure alone accounted for half of these savings. Premiums paid (€6 billion) when issuing new securities made a crucial contribution here. These are recognised in profit or loss in their full amount in the same year, which increases the volatility of interest expenditure and, in the event of a sharp shift on the capital markets, could lead to significant additional strain being placed on the central government budget in the short term. In order to ensure that developments remain more stable – an essential pre-

Result considerably better than forecast

The result was almost €12½ billion better than forecast in the 2016 supplementary budget.⁹ As a result, the €6 billion withdrawal from the refugee reserve that had been planned so as to close the 2016 financial year without posting any net borrowing, ie with a balanced budget, was no longer needed. Revenue exceeded the amount envisaged in the budget by €6½ billion. Despite the tax-share transfer of €4½ billion to state government at the end of the year, tax revenue was up by €1 billion. This was accompanied by other additional revenue of €5½ billion.¹⁰ Expenditure was €5½ billion

⁹ The only difference between the original budget plan drawn up at the end of 2015 and the supplementary budget draft of November 2016 – which was adopted unchanged by the Bundestag in February 2017 – was that the estimates for interest expenditure were lowered by €3½ billion, which covered the newly envisaged transfer to the fund to promote municipal investment.

¹⁰ Up by just over €½ billion in each case, this included, in particular, additional guarantee repayments, the Bundesbank's profit distribution, a contribution refund by the supplementary pension scheme of central and state government for salaried employees, and payments from the EU budget.



entire reserve could be used to repay debt in the budget, which would provide reliable, sustained budget relief by means of lower interest expenditure.

In an initial press release published in mid-January, the Federal Ministry of Finance put the structural result for 2016 as defined in the debt brake rules at -0.1% of GDP (see the table on page 63). The surplus in the core budget was neutralised by a reserve top-up of the same amount (no net borrowing).¹² A slight cyclical burden in arithmetical terms is cancelled out by a surplus from financial transactions. The figure includes the (provisional) balances of three off-budget entities – the flood relief fund, the fund to promote municipal investment (excluding the additional transfer already taken into account in the core budget) and the energy and climate fund – with a total deficit of €2½ billion. The reported structural funding gap in relation to GDP was therefore ¼ percentage point below the debt brake ceiling, with a corresponding amount normally having to be credited to central government’s control account.¹³

Structural result broadly balanced in 2016, leading to considerable credit entry for control account

requisite when it comes to budget planning and implementation – in the future, such amounts could be spread over a bond’s life.¹¹ Significant savings were also made vis-à-vis the budget plan in the case of investment expenditure. In addition to the lower-than-expected calls on guarantees, funds used for broadband network extension, in particular, fell far below what was budgeted for.

The Bundestag adopted the 2017 central government budget, too, with no authorisation for net borrowing. As in the 2016 budget, a withdrawal from the refugee reserve (€6½ billion) is planned in order to offset a deficit stemming from spending in connection with refugee migration. However, at least some of the positive deviations from the budget plan in 2016 are likely to extend into this year. In particular, continued higher-than-envisaged grants from

Starting point for 2017 budget much better than planned, ...

Reserve top-up not prudent

Pursuant to the Budget Act (*Haushaltsgesetz*), the surplus is to be transferred to the refugee reserve set up at the end of 2015, which will grow to €18½ billion as a result. However, as it was possible to cover the costs of support for refugees without dipping into this reserve last year, and spending in connection with this is now easier to gauge, it would not appear prudent to top up the reserve as this might effectively cause the funds to be used for other purposes. Instead, rather than using just the 2016 surplus – as proposed by the Federal Finance Minister when presenting the figures – the

¹¹ This manner of accounting would be more in line with that of the national accounts, to which the EU fiscal rules refer.

¹² This recording of transfers to and from reserves contravenes the EU fiscal rules. Following these rules, the structural result would have been 0.2 percentage point higher.

¹³ For more information on the control account, see Deutsche Bundesbank, The debt brake in Germany – key aspects and implementation, Monthly Report, October 2011, pp 15-39. In a welcome step, the extensive total balance for this account, which was accrued during the transitional period for reaching the regular ceiling, was cancelled once this period came to an end at the close of 2015.

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

	2015	2016			2017
	Actual	Budget	Supplemen- tary budget ¹	Provisional actual	Budget
1 Fiscal balance	11.8	- 6.4	- 6.4	5.9	- 7.0
2 Coin seigniorage	0.4	0.3	0.3	0.3	0.3
3 Transfer to (-)/withdrawal from (+) reserves	- 12.1	6.1	6.1	- 6.2	6.7
4 Net borrowing (1+2+3)	-	-	-	-	-
5 Balance of financial transactions	1.9	0.1	0.1	0.6	- 0.7
6 Cyclical component in the budget procedure	² - 1.4	0.3	0.3	³ - 0.4	- 1.9
7 Balance of incorporated off-budget entities	4.5	- 5.4	1.0	- 2.5	- 3.2
Energy and climate fund	1.9	- 0.4	- 0.2	- 0.0	- 1.5
Flood assistance fund	- 0.9	- 3.5	- 2.2	- 2.3	- 1.0
Fund to promote municipal investment	3.5	- 1.5	3.4	⁴ - 0.1	- 0.8
8 Structural net borrowing (4-5-6+7) (repayment: +; borrowing: -)	4.0	- 5.8	0.6	- 2.7	- 0.6
9 Structural balance (8-2-3)	15.8	- 12.1	- 5.8	3.2	- 7.6
10 Structural balance adjusted for updated estimate of potential output	17.5	- 12.1	- 5.7	2.6	- 8.3
11 Debt brake ceiling (from 2016: -0.35% of GDP ⁵)	- 18.6	- 10.2	- 10.2	- 10.2	- 10.6

* For more information, see Deutsche Bundesbank, Public finances, Monthly Report, February 2016, pp 68-69. ¹ Draft of November 2016 adopted by the Bundestag without adjustments. ² Pursuant to the 2015 budgetary account; provisional. ³ Simplified procedure applied: adjusted to the national accounts figures published in mid-February 2017. ⁴ Excluding the €3.5 billion transfer taken into account in the central government budget (in item 1), which has a negative impact on the balance. ⁵ GDP: gross domestic product. Here, this refers to GDP in the year before the budget is prepared.

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the EU and lower net burdens from guarantees and investment grants appear likely.¹⁴

distribution could be reduced on account of increased provisions for interest rate risk arising from the public sector purchase programme.

... but there are also risks, not least in connection with court rulings

By contrast, spending on unemployment benefit II (means-tested benefit) could rise more sharply than planned. Taking into account last year's actual figures, central government spending on this item is set to increase by 3%, with the benefit increases at the start of the year claiming a large part of this. Significant additional expenditure may arise as growing numbers of asylum seekers are granted refugee status, thereby becoming eligible for basic allowance benefits. While there were many successful applications for asylum last year, it is unlikely that the majority of these applicants have since secured a living wage. In addition, there remain a large number of asylum applications to be processed. Marked burdens may also arise in connection with court rulings on the accelerated phasing-out of nuclear energy or on whether the nuclear fuel tax is constitutional. Furthermore, the Bundesbank's profit

All things considered, it may be possible to leave the refugee reserve untouched this year as well – provided the current expectations regarding macroeconomic developments prove true, the interest rate level remains stable at the long end and further strains on the central government budget to the benefit of state and local government and in the run-up to the general election are avoided. The ceiling as defined in the debt brake rules would then be maintained with a safety margin.

Central government budget set to comfortably comply with debt brake in 2017, too

The benchmark figures for the 2018 central government budget and the medium-term financial plan up to 2021 will be adopted by

¹⁴ The positive base effect resulting from better-than-expected tax revenue could be counteracted in 2017 by delayed tax refunds stemming from earlier court rulings; see p 60.

Substantial additional burdens to be factored into further planning; leeway thus appears exhausted

the Federal Cabinet in mid-March. Based on the November 2016 tax estimate, annual revenue shortfalls of around €2 billion now need to be factored in compared with the previous financial plan from the summer of 2016. Account now also needs to be taken of the income tax cuts and rises in child benefit from 2018 onwards, involving losses of up to €3 billion, as well as the granting of a flat immigrant integration payment in the form of forwarded turnover tax of €2 billion to the federal states. Further revenue-side burdens initially amounting to €9½ billion per year from 2020 onwards can be foreseen on the basis of draft legislation on the reform of federal financial relations. Moreover, there are risks attached to the Bundesbank's profit. Defence expenditure may also be additionally increased in the medium term in line with the North Atlantic Council's agreement.¹⁵ Overall, the medium-term plans to date have included global revenue shortfalls as a precautionary measure. However, some of these funds were set aside for the municipal relief package of €5 billion per year from 2018 onwards, which has now been adopted. While the remaining provisions are set to grow significantly, from €2 billion in 2018 to almost €9 billion in 2020, they will not be sufficient to fully finance the revenue-side burdens which have already been specified in detail. In view of this and given the generally high level of uncertainty, it would appear advisable to avoid placing any further additional burdens on the central government budget.

Central government's off-budget entities in deficit for 2016 as a whole ...

According to provisional figures from the Federal Ministry of Finance, central government's off-budget entities (excluding bad banks and other entities that use commercial double-entry bookkeeping) concluded 2016 with a deficit of €3 billion. In 2015, they recorded a surplus of €9 billion, largely as a result of frontloaded payments to the fund to promote municipal investment and the energy and climate fund. As in the previous years, the off-budget entities for civil servant pension obligations posted marked surpluses (now €2½ billion), and the Financial Market Stabilisation Fund (SoFFin) also

achieved a surplus of €1 billion resulting from repayments of capital injections. By contrast, the transfer of revenue obtained in 2015 by the restructuring fund to the new European bank resolution authority (-€1½ billion) and the premiums on the redemption of an inflation-indexed Federal bond (-€2 billion) had a negative impact. In addition, the flood assistance fund recorded a discernible deficit (-€2½ billion), largely because of a transfer to the central government budget. The fund to promote municipal investment registered a slight deficit, with withdrawals remaining subdued.¹⁶

Central government's off-budget entities for civil servant pension obligations are expected to continue recording significant surpluses this year. As no repayments of inflation-indexed Federal bonds are due, the off-budget entity established for that purpose is also likely to post a moderate surplus as a result of the regular transfers it receives. Given cash reporting of the increased inflows to the fund to promote municipal investment in 2017, it would record a discernible surplus, even though significantly larger outflows from this fund are likely, not least because the field of application has been expanded to include education. Although central government is expecting the energy and climate fund and the flood assistance fund to record deficits, even then a surplus would be likely overall.¹⁷

... but surplus likely for 2017

¹⁵ Summit statement from 5 September 2014.

¹⁶ As the supplementary budget for 2016 had not yet entered into force when the figures were published, the renewed frontloading of transfers to this fund planned by central government had not yet been taken into account.

¹⁷ It is possible that the foundation for funding nuclear waste disposal, which is likely to record one-off revenue of around €23½ billion for 2017, will be included in the reporting group. See Deutsche Bundesbank, Public finances, Monthly Report, November 2016, p 68. The European Commission must confirm a priori that the arrangement is compatible with the EU state aid rules.

State government budgets¹⁸

Large surplus in 2016, not least due to transfer of central government tax funds

State government's core budgets concluded 2016 with a large surplus of €9 billion, which was a much better outcome than in 2015 (surplus of €3 billion).¹⁹ This improvement was due, not least, to transfers of central government tax funds. In December, the federal states received turnover tax funds via a frontloaded final settlement of flat refugee cost reimbursements (€2½ billion), and via a flat immigrant integration payment (€2 billion). Buoyed by the (thus additionally strengthened) growth in tax receipts (+8½%), revenue rose by a total of just over 6% (just over €20½ billion). By comparison, growth in expenditure was much weaker (+4½%, or just under €15 billion). The largest single contribution to this growth was made by ongoing payments to local government (+11½%, or €8½ billion), which were partly financed from transfers of central government funds. In addition, other operating expenditure saw exceptionally strong growth of 12½% in connection with support for refugees. The rise in personnel expenses was much more subdued (+3½%), while the decline in interest expenditure (-10½%) had a marked alleviating effect on state government finances.

Almost all states posted surpluses but recovery procedures still ongoing for Bremen and Saarland

All of the federal states except Saarland finished 2016 in surplus. While only the consolidation assistance it received enabled Bremen to record a small surplus, Berlin, notably, achieved a significant surplus even if consolidation assistance is factored out. On balance, the slight surplus recorded by North Rhine-Westphalia was evidently due to the realisation of financial assets. At its meeting in December 2016, the Stability Council concluded that the budgetary recovery procedures that had been launched in 2012 for Berlin and Schleswig-Holstein would be closed in 2016, while Bremen and Saarland would both require an extension as their budget figures were still unsatisfactory.

Surpluses continuing this year and in the medium term

This year and in the medium term, state government as a whole can be expected to record persistent surpluses. This was also reflected by

the Federal Ministry of Finance's projection for the period up to 2020, which it put together for the Stability Council's December meeting. This envisaged favourable underlying conditions in the form of significant rises in tax revenue and a continued easing of financial pressures thanks to the low interest rates. Central government grants to cover refugee-related expenses were particularly high last year, however, and it seems plausible that not all of these funds have yet been spent. Furthermore, tax refunds due to court rulings, which were initially expected for last year, may now largely take effect in 2017. The surpluses could therefore be more moderate than last year.

In December 2016, the Federal Cabinet adopted the draft legislation on the reform of federal financial relations from 2020 onwards, which was based on the agreements reached by central and state government in October 2016. Although the planned reform simplifies the state government financial equalisation system, it does not greatly improve its transparency or the incentives for state governments to take responsibility for their own fiscal and economic policy.²⁰ In future, central government will only grant its envisaged budgetary recovery assistance for Bremen and Saarland in full if a portion of the funds – albeit a comparatively small one – is used to pay off debt. As well as extending the field of application for its investment grants to include education in municipalities with weak financial capacity, central government is to gain stronger powers to influence the state government investment programmes receiving financial assistance in order to better ensure their compatibility with its goals.

Draft legislation on reform of federal financial relations attaches repayment conditions to recovery assistance ...

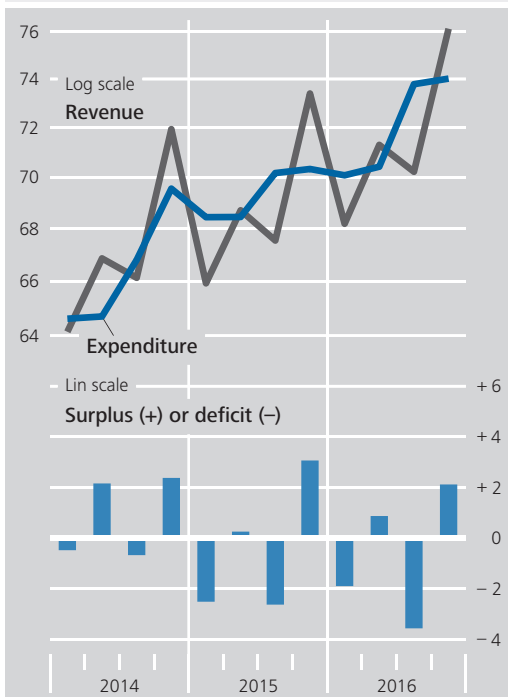
¹⁸ The development of local government finances in the third quarter of 2016 was analysed in the short articles of the Bundesbank's January 2017 Monthly Report. These are the most recent data available.

¹⁹ According to the monthly cash data, and adjusted for the booking of repayments to off-budget entities in Saxony which affected the deficit. According to the quarterly cash statistics, the surplus for 2015 came to only €½ billion, particularly because closing entries in favour of off-budget entities were made.

²⁰ For more information, see Deutsche Bundesbank, Public finances, Monthly Report, November 2016, pp 63-71.

Finances of the German statutory pension insurance scheme

€ billion, quarterly data



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

■ Social security funds²⁴

Statutory pension insurance scheme

According to provisional figures, the statutory pension insurance scheme recorded a deficit of €2½ billion in 2016. This was around €2 billion lower than estimated, and the reserve remained above its statutory upper limit at just over 1.6 times the scheme's monthly expenditure. However, the deficit was larger than it had been a year earlier (2015: €1½ billion). This was due to the exceptionally large mid-year pension increase (western Germany: 4.25%; eastern Germany 5.95%), which was driven up by a special factor that had dampened the previous increase.²⁵ However, growth in contribution receipts also remained strong (+4%), buoyed by the favourable employment and wage developments. A marked rise in revenue is expected again this year, partly because a reduction factor of just over €1 billion in the central government grant will no longer apply. Financial pressures on the scheme are set to increase in view of demographic change alone, leading to a greater depletion of reserves. Central government's pension insurance report published in autumn 2016 states that contribution rate increases can be expected from 2022 onwards, as the lower reserve limit of 0.2 times the scheme's monthly expenditure would otherwise be undershot.

2016 deficit smaller than planned but depletion of reserves foreseeable in view of demographic change

The deterioration in the scheme's finances will be exacerbated by central government's new

... and envisages monitoring of debt brake in line with European rules

The fact that the Stability Council will, in future, monitor central and state government's compliance with the constitutionally-enshrined debt brake while taking recourse to the European fiscal rules is a welcome development. Although the details have yet to be confirmed, this would mark out important guiding principles, such as the inclusion of the off-budget entities categorised as belonging to the government sector²¹ and a focus on the fiscal balance rather than net borrowing.²² To ensure successful monitoring of budgets within the German federal system, comprehensive, comparable data on the budgetary developments and planning of the individual state governments must also be made available.²³ As a general point, it would be desirable to ensure that sanctions can be imposed if a state is found to have responded inadequately to undesirable budgetary developments. Obliging states to repay debt promptly could also play a major role in securing desirable outcomes, however.

²¹ For example, Berlin intends to transfer most of last year's surplus to a special fund for investment in infrastructure. Its subsequent deficits would then be counted towards the debt brake limit.

²² This means that transfers to and from the reserves would have no impact on compliance with the upper limits.

²³ See Deutsche Bundesbank, The role of the Stability Council, Monthly Report, October 2011, p 23.

²⁴ The financial development of the public long-term care and statutory health insurance schemes in the third quarter of 2016 was discussed in the December 2016 Monthly Report. These are the most recent data available.

²⁵ See Deutsche Bundesbank, Public finances, Monthly Report, May 2016, p 72.

Intended benefit increases put more pressure on statutory pension insurance scheme's finances

pension policy initiatives, which will entail significant additional expenditure in the future. These notably include the harmonisation of pensions in eastern Germany with those in western Germany and pension increases for persons with reduced earning capacity. The benchmark pension in eastern Germany is to be increased in seven stages from its current level of just over 94% of the western German level so that the two are harmonised by 2025 at the latest. In return, the higher valuation of the wages of persons in eastern Germany insured for pension purposes is to be gradually phased out. Under the planned design, however, there will be a long transitional period during which pensions will increase further in net terms in eastern Germany.²⁶ This will profit those already drawing a pension and those approaching retirement, while younger cohorts will not experience a net benefit from the higher valuation of wages. To finance part of this additional expenditure, transfers from the central government budget are to be increased in stages from 2022 to 2025 by €2 billion in the long term, which corresponds to around half of the additional expenditure. For the pensions of persons with reduced earning capacity, a further extension of the reckonable period by three years is planned in stages between 2018 and 2024.²⁷ In future, it will thus be assumed that those with reduced earning capacity have made contributions up to the age of 65. The intention is, not least, to reduce the relatively high proportion of persons with reduced earning capacity who additionally depend on the basic allowance. If the expansion of benefits increases the number of people claiming pensions for reduced earning capacity, this will put more pressure on the finances of the statutory pension insurance scheme.

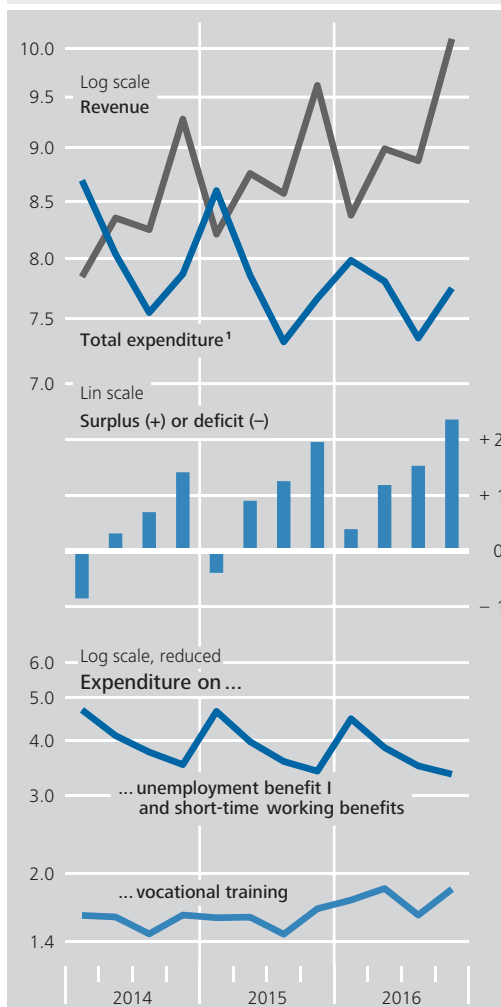
Federal Employment Agency

The Federal Employment Agency's core budget was €5½ billion in surplus in 2016, thus exceeding the figure for 2015 (€3½ billion) and, to a greater extent, the budget estimate (€2

Surplus increased significantly in 2016

Finances of the Federal Employment Agency

€ billion, quarterly data



Source: Federal Employment Agency. ¹ Including transfers to the civil servants' pension fund.
 Deutsche Bundesbank

billion). The scheme's reserves thus swelled to €13½ billion.²⁸ While revenue grew significantly (by 3½%), expenditure fell (by just over 1½%). There was a fall in spending on unemployment insurance benefit I (insurance-

²⁶ The combination of a lower benchmark pension and a higher valuation of wages currently means that in eastern Germany the same wage results in higher pension entitlements than in western Germany.

²⁷ The reckonable time was already extended by 2 years through the 2014 pension benefits package.

²⁸ The free reserves (excluding the components assigned for insolvency benefit and winter construction workers benefit) stood at €11½ billion. In addition, the pension fund once again posted a surplus of almost €½ billion, which brought its reserves for the complete funding of civil servants' pensions up to €5½ billion.

related benefit) and on subsidies for partial retirement, which are being phased out. By contrast, more funds were spent on active labour market policy measures. This reflects greater uptake of education and training programmes, not least in view of refugee migration.

Surplus planned for 2017 despite strong expenditure growth

The Federal Employment Agency's budget plan for 2017, which was approved in December last year, envisages a marked reduction of the surplus to €1½ billion. A sharp rise in expenditure on active labour market policy measures (of one-quarter to €9 billion) is planned. This is partly due to additional costs relating to the labour market integration of refugees, but the majority is accounted for by other measures. Unemployment insurance benefit I is also set to see a strong rise. However, the underlying assumption of a significant increase in the number of beneficiaries appears pessimistic in view of favourable labour market developments, which are also predicted in central government's forecasts. Part of the deterioration (of just over €½ billion) in the budget position is due to an additional transfer to the Federal Employment Agency's pension fund, which is

related to the current low interest rates. All in all, in light of the cautious expenditure appropriations in the core budget, the surplus could turn out to be much larger than projected.

According to current forecasts, the labour market situation is expected to remain favourable in the next few years. If the current expenditure policy continues, the agency seems likely to see further rises in its surplus and a sharp increase in its reserve. In general, however, a change of tack should be viewed critically. In the past, work promotion schemes have often proved to be counterproductive,²⁹ and tasks for society as a whole should not generally be funded from contributions but from tax revenue. Although the cyclical volatility of the agency's finances means that it generally makes sense to build up a large reserve in good times, given the current outlook, the option of cutting the current contribution rate of 3.0% would be worth consideration.

Contribution rate cut worth consideration

²⁹ See, inter alia, T Büttner, T Schewe and G Stephan, The effectiveness of labour market policy instruments, IAB Brief Report 8/2015.