Public finances*

General government budget

2023 as a whole

Government finances in 2023 far better than planned

Germany has so far weathered the energy crisis better than adverse scenarios were predicting. Government finances are faring better as well. In particular, the lower energy prices are decreasing the costs to government for the energy price brakes and the assistance provided for gas trading companies. As things stand today, the deficit ratio is likely to remain broadly unchanged at around 2½% this year. By contrast, last autumn's plans foresaw a significant increase to over 4%.[1]

Both significant relief and burdens compared with 2022

This year will bring with it both significant relief and burdens for government finances compared with 2022. Government revenue is likely to see continued robust growth. This is because it is largely dependent on gross wages and salaries (less bonuses exempt from social contributions) and nominal private consumption. Another alleviating factor is the fact that, having had a considerable effect on government finances last year, the impact of coronavirus response measures is now negligible. Looking at the support measures implemented in response to the energy crisis and high inflation, on the one hand, the one-off burdens from 2022 no longer apply. Examples of these include the energy price allowances, immediate assistance for gas and heating bills and possibly also the support provided to gas trading companies. On the other hand, the broad-based energy price brakes and further assistance from the Economic Stabilisation Fund for Energy Assistance (ESF-E) have come into play in 2023. Beyond support measures of this nature, the Federal Government is planning significant additional spending on defence and climate change mitigation this year. Interest expenditure will also rise sharply. This year's adjustment of the income tax scale to account for inflation will probably largely eliminate bracket creep in the current year.[2]

Outlook for 2024 and the medium term

Deficit to decline in 2024 before moving sideways

As things stand today, the deficit ratio will fall to somewhere between 1% and 1½% next year, mainly because the temporary support measures created in response to the energy crisis will have expired for the most part. As of 2025, the deficit ratio could move sideways. However, the Federal Government is discussing new budgetary burdens, such as higher defence spending and subsidies for cheaper industrial electricity. It has not yet agreed on a new financial framework for 2024 onwards.

Use of emergency borrowing from recent years still planned in medium term

Medium-term deficits will arise not least in special funds. The purpose of these funds is to finance spending on defence and in connection with climate change mitigation and energy transformation through additional borrowing.[3] In some cases, there are still plans or the option remains open to use emergency borrowing that was approved between 2020 and 2022. Some federal states have recently activated the escape clause in their debt brakes to create long-term financial leeway. In addition, limited structural deficits in core budgets are compatible with the debt brakes. This is also true for

* The section entitled "General government budget" relates to data from the national accounts and the Maastricht debt ratio. This is followed by reporting on budgetary developments (government finance statistics) where data for the first quarter of 2023 are available.
1 See Stability Council (2022).
2 See Deutsche Bundesbank (2022a) for more information on how bracket creep is usually offset.
3 In some cases, the plan is that they use reserves built up from debt-financed central government grants. The related central government loans are only recorded in the budget, and the reserves are corresponding counter-entries without any cash resources. It is only when cash expenditure needs to be financed that central government takes out loans on the capital market to this end.

the federal states, not least in connection with reserves.

Debt ratio will fall towards 60% in medium term

In view of the deficits, debt is likely to rise further. If fiscal policy remains unchanged, however, the debt ratio will probably decline and could return to around 60% in the medium term (2022: 66.3%). This is mainly due to the fact that growth in nominal gross domestic product (GDP) in the ratio's denominator is stronger than debt growth. In addition, the government is likely to reduce debt in connection with coronavirus assistance loans and bad bank portfolios. It should be noted, though, that Germany is also required to pay for EU debt without this being visible in the German debt ratio. Under NextGenerationEU (NGEU), the European Union is borrowing to make grants to the Member States. This EU debt is to be repaid jointly by the Member States starting in 2028. Based on Germany's regular share of financing, this will result in a cumulative burden of 2¼% of GDP for the country by the end of 2026.

Fiscal surveillance is in need of improvement

Fiscal surveillance requires current projections

Effective fiscal surveillance needs to take account of current developments. Instead, both the latest stability programme from April and the Stability Council's deliberations at the start of May were based largely on the outdated figures projected in summer and autumn 2022. Such an outdated projection is unsuitable for fiscal surveillance – something that has also been pointed out by the Independent Advisory Board to the Stability Council.[4]

Do not rebudget savings from crisis measures

Crisis assistance cheaper because energy prices are lower than expected

The budgetary burdens arising from energy price brakes and payments to gas trading companies are likely to be significantly lower than planned. This is due to lower energy prices easing the burden on the private sector, with the fiscal measures associated with the burden becoming correspondingly cheaper. Much like automatic stabilisers, the costs to government of these measures respond automatically to economic developments, so if deficits are lower as a result, this is not an expression of a more restrictive fiscal policy.

To avoid making monetary policy more difficult, do not rebudget resources that are left over

It would not be appropriate for the economy as a whole for the new borrowing originally budgeted for energy price assistance – but which is no longer needed – to now be used elsewhere. This would increase the degree of fiscal expansion, which would be likely, in turn, to increase inflationary pressures. In the current environment, the fiscal policy stance should not make the task of monetary policy more difficult. This is another reason why Germany and the other euro area Member States should limit their deficits. Broad-based crisis assistance should be phased out in a timely manner. In this context, it would not be advisable to extend the energy price brakes beyond the end of 2023.

Reinforce the binding effect of fiscal rules

Debt brake escape clause planned for medium term

Whilst it is true that central government and most state governments are no longer officially making use of the debt brake escape clause, fiscal policy will effectively be financed by exceptional means in the medium term as well. Specifically, central government and state governments have created scope – by means of the Armed Forces Fund and unallocated emergency borrowing – to run up considerable deficits in the medium term. With respect to the pandemic-related emergency borrowing of 2021, the Federal Constitutional Court is examining whether central government was allowed to put aside resources that were left over in the Climate Fund. This ruling could also provide

4 See Independent Advisory Board to the Stability Council (2023).

general indications as to the extent to which it is permissible to fund future deficits upfront using emergency borrowing.

Reliably safeguard government's ability to act

There is no doubt that climate change, the energy transition and the geopolitical situation will put policymakers to a stiff test for quite some time. Debt-limiting fiscal rules do not prevent the government from taking action. They do, however, force it to set priorities. This means scaling back less important expenditure or generating additional revenue. Sound government finances are not at odds with forward-looking government activity – far from it. Rather, they are its basis, and they ensure that the government is able to act even in crises.

Debt brake needs to be more binding once again, possibly with a somewhat broader regular borrowing framework

The debt brake makes for a comparatively restrictive borrowing framework, so there does appear to be scope for a stability-oriented reform; one which leaves somewhat greater fiscal space as long as the debt ratio is relatively low. At the same time, however, such a reform should strengthen the binding effect of the rules again, which has diminished over the past few years.[5] Otherwise, it can be expected that fiscal policy will repeatedly pass on the costs of its decisions to future generations and put monetary policy under pressure.

Budgetary development of central, state and local government

Tax revenue

First quarter of 2023

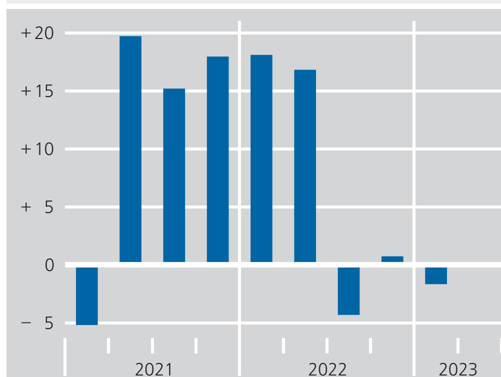
Tax revenue fell in Q1 – changes in tax law bring considerable strain

Over the first three months of 2023, tax revenue[6] fell on the year (-1½%, or -€3½ billion; see the chart above and the table on p. 60). Cuts in wage and income tax and VAT, in particular, had a dampening effect. Otherwise, revenue would have increased slightly.

In the absence of tax cuts, revenue from wage tax would probably have risen by around 5½%.

Tax revenue*

Year-on-year percentage change, quarterly figures



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

Wage tax: tax cuts and raising of child benefits significantly reduced growth

Owing to various tax cuts, it actually fell by 1%. In particular, the tax scale was adjusted to last year's high inflation rate at the start of this year.[7] In addition, the basic income tax allowance and employees' standard deduction for income-related expenses were raised in mid-2022. This measure had an impact in year-on-year terms. In addition, it has been possible to fully deduct contributions to the pension insurance scheme since the start of this year. Furthermore, spending on child benefits rose sharply overall, as these were raised as the year began. This reduced the growth rate for wage tax because child benefit payments are deducted from wage tax revenue. Lastly, the recently observed increase in gross wages and salaries will yield less wage tax revenue growth than usual: in 2023 and 2024, temporary additional wage payments totalling up to €3,000 are tax-exempt.

Revenue from profit-related taxes fell by 3%

Profit-related taxes fell by 3%. Advance payments for the current year, which are particularly important for revenue, remained stable. At the same time, however, tax payments for pre-

5 See Deutsche Bundesbank (2022b).
6 Including EU shares in German tax revenue. Receipts from local government taxes are not included. These were not yet known for the quarter under review.
7 Some of the measures mentioned are not fully included in the data from the first quarter, as wage tax is recorded with a lag.

Tax revenue

Type of tax	Q1 2022	Q1 2023		Estimate for 2023[1]
	€ billion		Year-on-year change %	Year-on-year change %
Tax revenue, total[2]	203.1	199.8	− 1.7	+ 2.9
of which:				
Wage tax[3]	56.2	55.7	− 1.0	+ 6.1
Profit-related taxes	40.0	38.8	− 3.1	+ 2.9
Assessed income tax[4]	20.9	19.7	− 5.7	+ 0.8
Corporation tax[5]	11.2	10.7	− 4.3	+ 0.4
Non-assessed taxes on earnings	5.1	6.6	+ 27.6	+ 12.9
Withholding tax on interest income and capital gains	2.8	1.8	− 36.2	− 4.7
VAT[6]	73.6	73.5	− 0.1	+ 1.6
Other consumption-related taxes[7]	20.5	21.3	+ 3.9	+ 5.0

Sources: Federal Ministry of Finance, Working Party on Tax Revenue Estimates and Bundesbank calculations. **1** According to official tax estimate of May 2023. **2** Comprises joint taxes as well as central government taxes and state government taxes. Including EU shares in German tax revenue, including customs duties, but excluding receipts from local government taxes. **3** Child benefits and subsidies for supplementary private pension plans deducted from revenue. **4** Employee refunds and research grants deducted from revenue. **5** Research grants deducted from revenue. **6** VAT and import VAT. **7** Taxes on energy, tobacco, insurance, motor vehicles, electricity, alcohol, air traffic, coffee, sparkling wine, intermediate products, alcopops, betting and lotteries, beer and fire protection.

Deutsche Bundesbank

vious years decreased. In addition, more taxes that had already been paid were reimbursed.

VAT stagnated, due in part to temporary cut in rate on natural gas and district heating

Receipts from VAT were at around the same level as in the first quarter of last year. The temporary cut in the VAT rate on natural gas and district heating up to the end of March 2024 played a major role in this. Also, the prior year's level was elevated – previously deferred VAT payments had been finally made in that year. In the absence of those two factors, revenue would probably have risen significantly.

Real estate acquisition tax fell by just over one-third (-€1½ billion). This corresponds to half of the decline in total tax revenue. Revenue has been dwindling to an increasing extent since mid-2022. The number and value of transactions are the determining factors behind real estate acquisition tax. Several drivers are likely to be reflected here. For example, high inflation and significantly greater financing costs are making residential real estate less affordable. In addition, construction is faced with supply-side barriers such as persistent shortages of materials and labour. As a result, real estate activity has slowed.

On balance, real estate acquisition tax accounted for half of decline in total tax revenue

Official tax estimate: solid tax revenue growth up to 2027

Tax estimate: tax revenue growth of 3% this year

According to the latest official tax estimate, tax revenue will rise by 3% on the year in 2023. The compensation for bracket creep in the income tax scale, in particular, dampens revenue growth considerably. As usual, bracket creep from the previous year is offset.[8] The VAT rate cut on natural gas and district heating, higher child benefits and tax-free inflation compensation bonuses also weigh significantly on revenue. The fact that revenue continues to rise at a steady pace is due to the reference variables for tax revenue seeing dynamic growth as a result of high price increases. This applies not least to gross wages and salaries per employee. In the projection, profit-related taxes rise less than entrepreneurial and investment income. This part of the tax estimate was largely based on the subdued cash developments over the course of the year to date.

Growth of 4½% in 2024

Revenue growth is expected to be 4½% in 2024. Projected profit-related taxes will continue to increase at a subdued pace. However, nominal private consumption and, above all, wages will see ongoing dynamic growth. Moreover, changes in tax law will have hardly any curbing effect on growth: although the income

8 The tax scale shift for 2023 is based on inflation in 2022, which was estimated in autumn 2022. For more information on the concept of the report on inflation-induced bracket creep and inflation-related adjustments to the income tax scale, see Deutsche Bundesbank (2022a), p. 66.

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

Item	2022	2023	2024	2025	2026	2027
Tax revenue[1]						
€ billion	895.7	920.6	962.2	1,009.3	1,046.2	1,078.5
% of GDP	23.2	22.4	22.5	23.0	23.2	23.2
Year-on-year change (%)	7.5	2.8	4.5	4.9	3.7	3.1
Revision compared with previous tax estimate (€ billion)	8.1	– 16.8	– 30.8	– 32.5	– 32.3	– 36.3
of which: Revision due to new changes in tax law	.	– 23.3	– 34.4	– 35.8	– 37.8	– 38.9
Memo item:						
Revenue shortfalls if bracket creep is compensated for in same manner as previously[2]	.	.	.	– 4.6	– 8.8	– 13.2
Real GDP growth (%)						
Spring projection (April 2023)	1.8	0.4	1.6	0.8	0.8	0.8
Autumn projection (October 2022)	1.4	– 0.4	2.3	0.8	0.8	0.8
Nominal GDP growth (%)						
Spring projection (April 2023)	7.4	6.1	4.0	2.8	2.8	2.8
Autumn projection (October 2022)	7.0	5.3	4.7	2.7	2.7	2.7

Sources: Working Party on Tax Revenue Estimates and Federal Ministry for Economic Affairs and Climate Action. **1** Including EU shares in German tax revenue, including customs duties, including receipts from local government taxes. **2** Since 2014, the income tax scale has shifted year after year, usually in line with the estimated inflation of the previous year. The figures shown here are the revenue shortfalls that will result if this practice is continued. The calculations are roughly estimated; they are based on the Federal Government's current spring projection and wage tax receipts based on current tax estimates (according to the national accounts). The basic income tax allowance also shifts in line with the inflation rate of the previous year.

Deutsche Bundesbank

tax scale will be lowered significantly in 2024, eliminating the bracket creep of the previous year, the temporarily reduced VAT rate on natural gas and district heating will return to the regular rate at the end of March 2024. There will also be additional revenue from the accelerated write-offs of previous years; these had depressed revenue, in particular up to 2022. Correspondingly fewer write-offs will now be made, which will raise tax revenue. In addition, fewer tax-free inflation compensation bonuses look set to be paid than in the previous year.

Average growth of 4% as of 2025

According to the tax estimate, revenue is projected to rise by an average of 4% in the years 2025 to 2027. In 2025, revenue growth will be stronger, at 5%, mainly because there will be no burdens arising from changes in tax law: accelerated write-offs will continue to generate additional revenue. In addition, the regular VAT rate on natural gas and district heating will then apply again throughout the full year. From 2026 onwards, changes in tax law will play no major role. The projection is therefore a fairly direct reflection of the assumptions regarding macroeconomic developments and progressive taxation. Growth of 3½% is envisaged.

Adjustment to rising minimum subsistence level and any compensation for bracket creep not taken into account from 2025

However, growth from 2025 is likely to be overstated. The basic income tax allowance will probably be raised further in order to keep the minimum subsistence level tax-free. Moreover, growth will be throttled to a greater extent if legislators compensate for bracket creep, as they have done in previous years.

Comparison with autumn estimate: revenue shortfalls due to tax cuts

Estimate significantly lower than autumn estimate, mainly because compensation for bracket creep is only now included

Compared with the autumn 2022 tax estimate, there are significant revenue shortfalls. They will increase from around ½% of GDP (-€17 billion) in 2023 to roughly ¾% of GDP from 2024. This is mainly due to tax cuts that have been agreed in the meantime. These largely comprise compensation for bracket creep, the in-

crease in child benefits and the previous full tax deductibility of contributions to the statutory pension insurance scheme. Excluding the tax cuts, however, the new estimate foresees moderate additional revenue.

Central government finances

Overview of 2023

Sharp increase in total deficit in Q1, due mainly to emergency energy measures

The central government deficit including off-budget entities[9] was considerably higher at the start of 2023 than it was one year ago. It rose by €33 billion to €52 billion. The deficit in the core budget was only moderately higher (at €21 billion). However, the ESF-E alone recorded a deficit of €26 billion. This was the result of the energy price brakes and further assistance, which central government funded upfront in 2022 via the escape clause.

Very large deficit expected for year as a whole, but much more favourable outcome likely

Central government anticipates a very large deficit of €232 billion this year. Its off-budget entities account for €146 billion of this sum.[10] The deficit is likely to be significantly lower, though. This is due to more favourable developments, amongst other things in the area of energy price assistance.

Central government budget: first quarter of 2023

Virtually stagnant tax revenue and moderate increase in expenditure amid numerous special factors

In the core budget, revenue was up by 1½% (+€1½ billion) on the year. Central government tax revenue increased only slightly. Total expenditure rose somewhat more sharply, climbing by 2½% (+€3 billion). Interest expenditure delivered a strong growth contribution (up by just over €8½ billion). The increase here was due almost entirely to discounts. These are highly volatile because central government immediately records them in full rather than allocating them over the term on an accruals basis.[11] Higher interest rates led to sharp markdowns in some cases for the usual tap issues of long-dated bonds. This is because some of them still carry very low coupons. In addition, central government paid out a loan to a new fund intended to tackle climate change and pandemics at the International Monetary Fund (€6½ billion). Besides that, expenditure on the basic allowance for job seekers (civic allowance, formerly unemployment benefit II) was up by one-fifth (+€2 billion). Around half of this is likely to be attributable to refugees from Ukraine. They have been eligible to receive these benefits since June 2022. In addition, central government expanded benefits at the start of the year. By contrast, payments to social security funds fell sharply (-€8½ billion). For example, special payments to the statutory health insurance scheme, e.g. for coronavirus tests for the general public, decreased. Furthermore, a smaller deficit offset for the Federal Employment Agency brought relief. Whereas central government paid €4 billion in coronavirus-related transfers for enterprises a year ago, there were now funds flowing back (negative expenditure of €1½ billion).

Central government budget: 2023 as a whole

Central government's budgetary objective for 2023 is easily attainable

The deficit of €86 billion estimated in central government's core budget remains easily attainable. Specifically, the latest tax estimate envisages additional revenue of almost €7 billion compared with the budget plan (including projected global revenue shortfalls). Central government's provisions for the pay agreement for salaried employees and associated pay rises for

9 This includes off-budget entities that use the single-entry system and for which quarterly data are available (see p. 64). These comprise, in particular, (i) the Economic Stabilisation Fund for Energy Assistance (ESF-E), (ii) the off-budget entities relevant to the debt brake up to 2021 and (iii) the Armed Forces Fund (see Deutsche Bundesbank (2023), table on p. 69, items 16, 17 and 19). In addition, the reporting group for off-budget entities includes, above all, (iv) the other funds shown in the central government budget's borrowing plan (for making provisions for repayment and for expanding childcare, both item 18) as well as (v) the precautionary funds for civil servants' pensions. In particular, the bad bank FMSW, the fund for the disposal of nuclear energy waste, the motorway company and the development aid company GIZ are excluded.
10 See Deutsche Bundesbank (2023), p. 69.
11 For a proposal on recording premia on an accruals basis, a less volatile accounting procedure, see Deutsche Bundesbank (2021a).

civil servants proved very generous. Possible additional expenditure on the civic allowance could thus be covered. Moreover, with coupons of new securities measured in line with the market, interest expenditure could be considerably lower than the budgeted figure.

Central government plans up to 2027

Government failed to agree on key figures

The central government budget is also expected to comply with the borrowing limit imposed under the debt brake in the years to come. However, the government was unable to agree on key figures for the budget in line with the debt brake and postponed the Federal Cabinet decision on the draft budget and fiscal plan up to 2027 that had been scheduled for 21 June.

Strained financial situation as early as next year, as well as large additional burdens in longer term

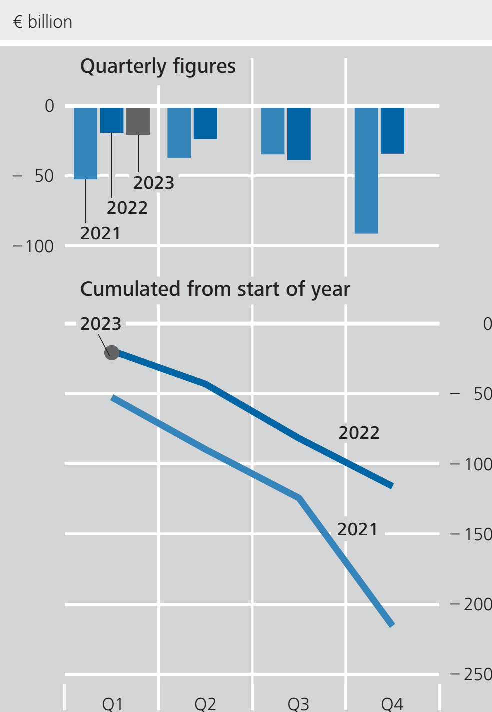
In actual fact, the central government budget is stretched. The last fiscal plan fully exhausted the debt brake limit. While the current tax estimate foresees additional revenue and the cyclical component of the spring projection expands the scope of borrowing somewhat for 2024, the old fiscal plan envisaged profit distribution by the Bundesbank, which is expected not to take place for a number of years. In addition, there have been stronger than projected price increases in the meantime. The pay agreement for salaried employees and associated pay rises for civil servants will also result in markedly higher spending than in the old fiscal plan. Moreover, new policy priorities have not yet been accounted for, among them defence spending. In the longer term, financial pressure will intensify sharply. By then, off-budget entities will have exhausted their scope for deficits, repayment burdens will be high and demographic change will increasingly weigh on central government finances.[12]

Federal Constitutional Court to decide on emergency borrowing to finance Climate Fund upfront

Financing pressure could mount earlier. The Federal Constitutional Court is deliberating whether to restrict the upfront funding of the Climate Fund using emergency borrowing.[13] Legislators purposefully tightened the Basic Law's escape clause upon introduction of the debt brake in 2009. Previously, the clause had made permanent additional borrowing all too easy. The second supplementary budget for 2021 falls within the context of the escape clause. This is because it was as part of this budget that legislators released €60 billion in unallocated pandemic-related emergency borrowing for future climate change mitigation measures. Legislators did not specify the measures to be financed using these funds, nor did they set an expiration date for the funds.[14] As was the case last year, the Climate Fund is ultimately unlikely to need the funds this year either. In this respect, it is not clear that the coronavirus crisis has directly led to an increase in borrowing requirements. At the same time, the court's decision could provide guidelines

Fiscal balance of central government budget*

€ billion

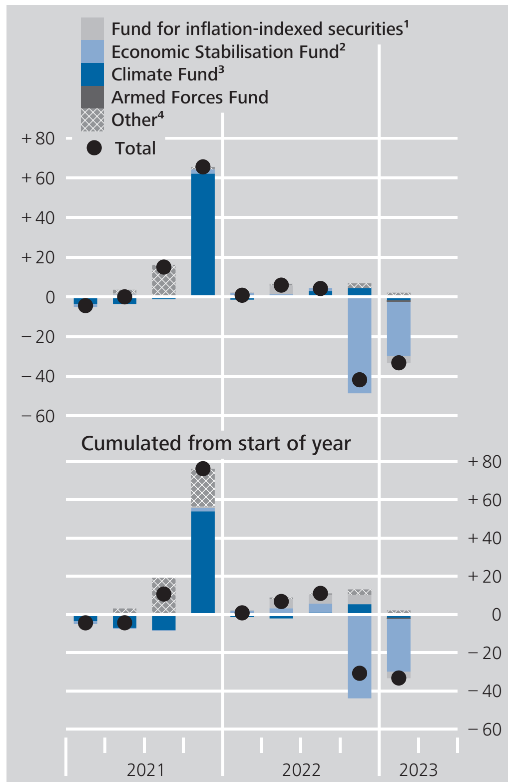


Source: Bundesbank calculations based on data from the Federal Ministry of Finance. * Excluding off-budget entities. Not adjusted for financial transactions or cyclical effects.
Deutsche Bundesbank

12 See Deutsche Bundesbank (2023), pp. 71 ff.
13 Oral proceedings are scheduled for 21 June 2023.
14 In tandem with the 2022 Budget Act, the Bundestag postponed the repayment plans previously adopted and extended them considerably. This approach severs the link between granting emergency borrowing and drawing up a repayment plan.

Fiscal balances of central government's off-budget entities*

€ billion, quarterly figures



Source: Bundesbank calculations based on data from the Federal Ministry of Finance. * Only entities using a single-entry accounting system, i.e. excluding, in particular, the bad bank FMS Wertmanagement and also deficits from refinancing FMS Wertmanagement incurred by SoFFin, which uses a single-entry accounting system. **1** Precautionary fund for final payments of inflation-indexed Federal securities. **2** Founded in 2020 for coronavirus assistance; expanded in autumn 2022 to cover energy price assistance. **3** Climate and Transformation Fund; up to 2022, Energy and Climate Fund. **4** In particular, special funds for reconstruction aid to cover flood damage, civil servants' pensions, digitalisation, expansion of childcare services and local government investment.
Deutsche Bundesbank

for the ESF-E. In 2022, it received its own emergency borrowing authorisations of €200 billion and used them in full – in large part to fill a reserve with €170 billion. State governments, too, are funding sizeable deficits in future fiscal years upfront using the escape clause.

Off-budget entities: first quarter and outlook for 2023 as a whole

Large deficit from measures taken in response to energy crisis

Central government's off-budget entities[15] recorded a large deficit totalling €31 billion (2022: +€½ billion) in the first quarter of 2023:

- The ESF-E recorded a deficit of €26 billion for payments in connection with the energy price brakes and supplementary assistance. Deficit growth will scarcely maintain its momentum over the course of the year, though. For example, the skimming of extraordinary revenues from high electricity prices will ease the strain on the ESF-E as the year progresses. Moreover, suppliers recently cut prices, which will reduce spending on the energy price brakes.

- The precautionary fund for final payments of inflation-indexed Federal securities recorded a deficit of €3½ billion. This was mainly due to payments for an inflation-indexed Federal bond that had to be redeemed in mid-April. As the year goes on, however, upcoming transfers from central government budget to the fund should lead to a relatively large surplus.[16]

- As in the previous year, the Climate Fund recorded a deficit of €1½ billion. It therefore does not appear to be a foregone conclusion that it will record the large deficit of €14 billion that was forecast for this year (previous year's result excluding the transfer from central government is roughly balanced).

- The Armed Forces Fund reported initial expenditure and thus a deficit of almost €1 billion. In order to make full use of the €8½ billion in its economic plan, its flow of expenditure would have to accelerate considerably further.

The ESF-E deficit will be the determining factor in the annual result of the off-budget entities

15 According to data from the Federal Ministry of Finance, i.e. excluding bad banks and other entities that use commercial double-entry bookkeeping.
16 The national accounts already include expenditure from the core budget to fill up this fund as current interest expenditure. As a result, it is not the repayment in April that affects the general government national accounts balance but the transfer from the core budget, which is up sharply compared with the previous year.

ESF-E deficit in 2023 likely to remain significantly below projected figure

as a whole. As things stand today, its deficit is likely to remain significantly below the projected figure of €121 billion.

State government budgets[17]

Core budgets in the first quarter of 2023

Core budgets deteriorated significantly in Q1

State government core budgets closed the first quarter with a deficit of €3 billion. In the same quarter of the previous year, they had posted a surplus of €14 billion. Revenue fell by 12%, with taxes decreasing significantly. However, it appears that not all taxes received by the state governments for the first quarter have yet been recorded in their budgets.[18] In addition, the central government payments to state governments for business aid were discontinued. Despite the smaller amounts of business aid to be forwarded, expenditure still went up slightly. This was mainly due to increased transfers to public administrations, especially to local governments. Furthermore, a reserve appears to have been created in an off-budget entity in Schleswig-Holstein. Significantly higher interest payments also contributed to expenditure growth.

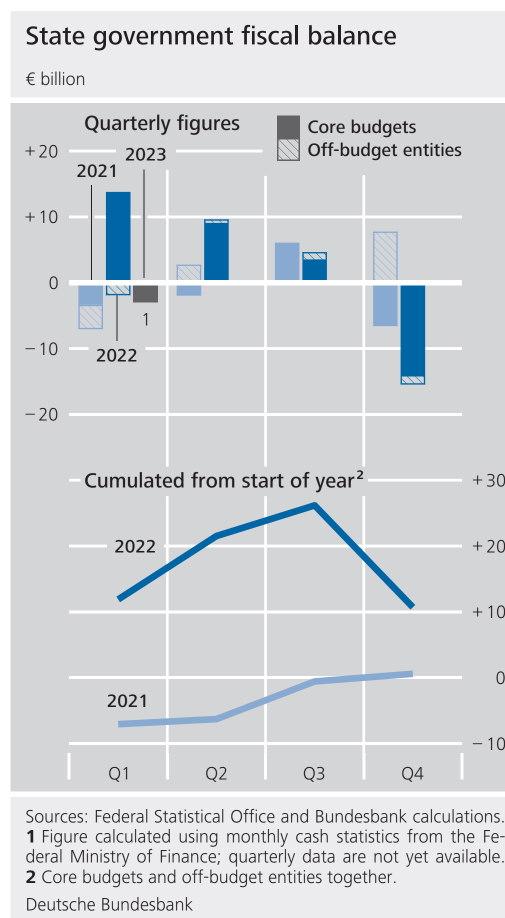
Core budgets and off-budget entities in 2023 as a whole

Deficit possible for core budgets and off-budget entities combined for year as a whole

The state government core budgets and off-budget entities combined could slip into a deficit this year (2022: surplus of €10½ billion). According to the new tax estimate, their tax revenue will decline slightly. On the expenditure side, the significant item of personnel expenditure is likely to go up markedly. This is mainly due to general pay rises, but also to the planned increase in staffing levels. In addition, some federal states will gradually raise the salaries of teaching staff at primary schools. The transfers to local governments are likely to continue rising over the year as a whole. Furthermore, some federal states could significantly boost their expenditure on climate change mitigation, energy price assistance or other economic assistance. At the very least, the relevant state parliaments have authorised their governments to do so.

State government fiscal balance

€ billion



Sources: Federal Statistical Office and Bundesbank calculations. **1** Figure calculated using monthly cash statistics from the Federal Ministry of Finance; quarterly data are not yet available. **2** Core budgets and off-budget entities together.

Deutsche Bundesbank

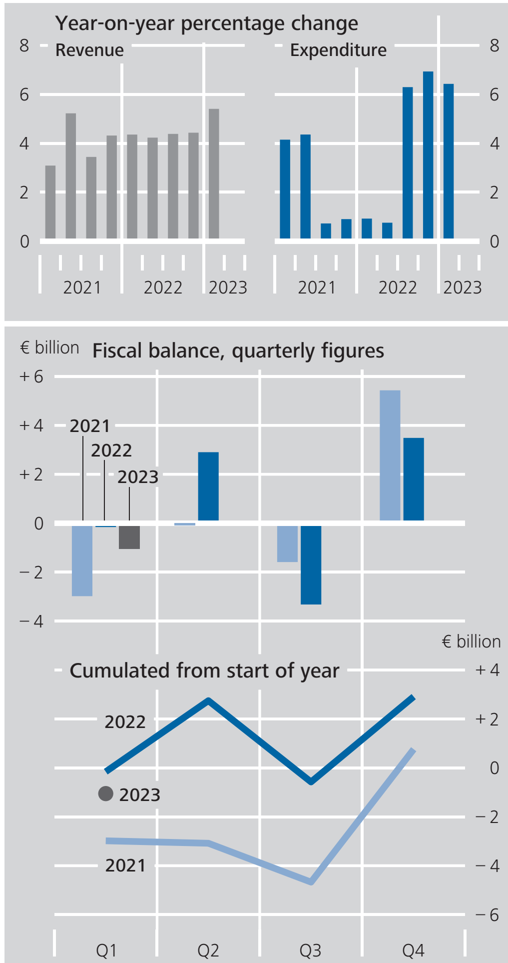
State government debt brakes

Numerous debt-financed, long-term transformation funds hamper effective debt brake

Some federal states have recently activated the escape clause in their debt brakes to create long-term financial leeway.[19] The parties in the new Berlin state government are also planning to do this. In their coalition agreement, a debt-financed special fund of €5 billion has been

17 The figures for the quarter under review are based on the monthly cash statistics for the core budgets.
18 The difference between taxes collected in the tax statistics and the monthly state government budget statistics amounted to around €5 billion in the first quarter of 2023, compared with -€½ billion in the first quarter of 2022. See the April issue of the Monthly Report of the Federal Ministry of Finance for the distribution of taxes collected in the first quarter across the levels of government (for the reporting quarter, see Federal Ministry of Finance (2023), p. 42), and the monthly cash statistics of the federal states' core budgets for the state government taxes collected.
19 For details on Bremen and Saarland specifically, see Deutsche Bundesbank (2023), p. 76.

Finances of the German statutory pension insurance scheme*



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

agreed. This sum is intended to finance measures for energy savings in the buildings sector, renewable energy, green mobility and economic transformation. However, the measures have not yet been fleshed out or priced. If the measures are deemed successful at the end of 2024, the parties intend to top up the special fund to €10 billion. Such resources will effectively suspend the standard limit under the debt brake for a number of years.[20] Ultimately, this will severely impair the binding effect of the debt brake, meaning that the latter will hardly be in a position to effectively limit debt.

Social security funds

Pension insurance scheme

First quarter of 2023

Deficit in Q1 following substantial pension increase in mid-2022

The statutory pension insurance scheme recorded a deficit of €1 billion in the first quarter of 2023. In the same quarter of 2022, its budget had still been broadly balanced. Pensions were raised substantially in mid-2022. This is the main reason why expenditure rose by 6½%. Total revenue grew by 5½% on the same quarter of the previous year. Contribution receipts increased by as much as 6%.

2023 as a whole

2023: previous year's surplus likely to decline significantly

The surplus looks likely to fall over the year as a whole: the high annual average pension increase could cause the surplus to decline significantly from the €3 billion recorded last year. Averaged across the year, individual pensions will see growth of 5%, which is noticeably stronger than in the previous year (3%). At mid-year, they will rise by just over 4½% (4.39% in western Germany and 5.86% in eastern Germany). This increase is mainly due to high wage growth in 2022, in which the increased minimum wage played a role. As wages went up more sharply in eastern Germany, the rise in pensions will be 1½ percentage points stronger in that region. This means that they will already match the level in western Germany this year – one year earlier than the statutory requirement. By contrast, the sustainability factor dampened the pension increase in both regions. In simplified terms, this factor thus takes into account the climbing ratio of pensions to contributions. The gradually accelerating rise in the number of pensions is already amplifying spending pressures

20 The coalition agreement does not set out a structurally balanced budget for Berlin until the two-year budget of 2028-29. In addition, the coalition parties are examining the possibility of debt-financing individual state institutions without this counting towards the debt brake. For more information on fiscal policy plans, see CDU and SPD Berlin (2023), pp. 125-131.

this year. On the revenue side, contributions are likely to see robust growth. Social contribution-exempt inflation compensation bonuses are having a marked dampening effect.

Medium-term outlook

Replacement rate: distance to threshold narrowing because of higher long-term care contribution rate

Following this year's pension adjustment, the replacement rate is just above the 48% threshold. However, the contribution rate to the long-term care insurance scheme is also set to rise by 0.35 percentage point at mid-year, a factor not taken into account by the Federal Government. This slightly reduces the replacement rate and thus the distance to the threshold. The reason for this is that pension recipients pay the entire contribution to the long-term care insurance scheme themselves. By contrast, employees' contributions are paid in part by employers. Therefore, the higher contribution rate is weighing on pensions more strongly in the numerator of the replacement rate than on wages in the denominator. The effect on the replacement rate is minimal, at less than 0.1 percentage point this year. However, it would make sense if, in the future, the government took into account the repercussions of a law coming into force at the same time.

Growing pressure on pension finances

Next year, the threshold for the replacement rate is likely to take effect for the first time. Pensions would then rise more sharply than expected on the basis of the adjustment formula. Funding pressures will be increased significantly further by the Federal Government's future plans, according to which the replacement rate will not fall below 48% after 2025, either. The contribution rate and central government grants would then have to rise more sharply than currently envisaged.[21]

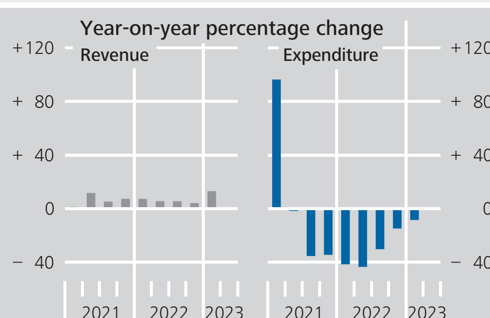
Federal Employment Agency

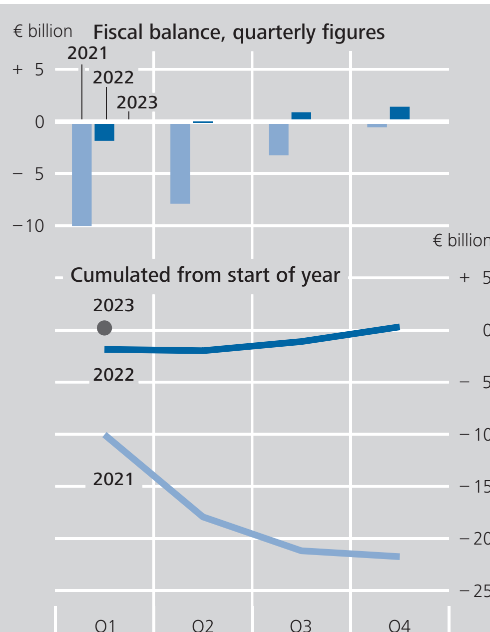
First quarter of 2023

The Federal Employment Agency reported a broadly balanced result for the first quarter of 2023.[22] This was an improvement of almost €2 billion compared with the same quarter of the previous year. Expenditure on short-time work, in particular, fell sharply (-70%). By contrast, spending on unemployment benefits grew by 7%, partly because the number of benefit recipients rose. Overall, expenditure fell by 7%, however. Revenue climbed substantially, by 11%. Of this, 9 percentage points were attributable to a rise of 0.2 percentage point in the contribution rate. Shortly before the pandemic,

Federal Employment Agency had broadly balanced result in Q1

Finances of the Federal Employment Agency*





Source: Federal Employment Agency. * Including transfers to the civil servants' pension fund and before payment of central government grants.
Deutsche Bundesbank

21 See Deutsche Bundesbank (2022c).
22 In the core budget, i.e. excluding the civil servants' pension fund. Transfers to the fund are recorded as expenditure, lowering the core budget balance.

central government legislators had lowered it to 2.4% until 2022. This step was intended to prevent a continued rise in the very high reserves at that time.

2023 as a whole

Significant surplus on the cards for 2023

The Federal Employment Agency's finances are likely to improve further this year. Overall, a significant surplus is on the cards. This could be markedly higher than the figure planned by the Federal Employment Agency (€2 billion).[23] According to the Federal Government's spring projection, developments in the economy as a whole are likely to be more favourable. As in the preceding years, the expenditure estimates for active labour market policy also suggest that there will be a distinct reduction in spending.

The reform of the EU's fiscal rules

The process of reforming the EU's fiscal rules is underway

Planned reform threatens to weaken EU's fiscal rules

On 26 April 2023, the European Commission (hereinafter "the Commission") presented legislative proposals to implement a reform of the EU's fiscal rules. These proposals are highly complex, and numerous details remain unresolved. Further negotiations are planned and adjustments are likely to be made. The main features of the proposals are presented below and subsequently evaluated. In addition, suggestions for amendment are made to address selected points of criticism. Overall, the reform proposals threaten to weaken rather than strengthen the EU's fiscal rules compared with the status quo prior to their suspension in 2020.

Bundesbank advocates stringent fiscal rules

The EU's fiscal rules are intended to safeguard sound public finances in EU Member States. This is key, in particular, to ensuring a stability-oriented monetary policy. The Bundesbank therefore advocates stringent fiscal rules. It has submitted reform proposals to various bodies.[24] From the Bundesbank's point of view, it is essential that the rules lay out reliable guide rails for sound public finances. It is therefore important that the rules have a clear focus on the objective of sound public finances. This should not be traded off against other policy objectives. The existing fiscal framework should thus be fortified with more binding, ex ante quantitative requirements. The rules should be implemented transparently and monitored in a clear and comprehensible manner.

The key features of the Commission's legislative proposals

Commission proposes complex procedure

The Commission's reform proposals aim to continue ensuring that Member States pursue a sustainable fiscal policy in the medium term. The rules are intended both to assure budgetary discipline and promote sustainable growth. Fiscal targets are intermingled with macroeconomic targets to a much greater extent than before. The macroeconomic imbalances procedure is to be integrated into fiscal surveillance. The rules leave room for interpretation on a number of points. Requirements are determined via relatively complicated procedures, and results are based on a large number of assumptions. The proposals envisage country-specific objectives. Furthermore, the Commission plans to give Member States more scope in the design of the adjustment paths taken to meet these objectives. It hopes that this will increase a sense of national responsibility for compliance with the rules (national ownership). The key features of the proposed rules are outlined below. Taken in their entirety, however, the proposals are more complex and, at times, ambiguous.

---

23 This year, the Federal Employment Agency will have to repay a central government loan of €½ billion from 2022. As was the case for the payment of the loan to the Federal Employment Agency in 2022, repayment will not affect the Federal Employment Agency's balance.
24 See also Deutsche Bundesbank (2021b).

Multiannual fiscal adjustment plans to play a pivotal role in the rules

Commission and Member States to agree on fiscal trajectory

In future, the Commission and the Member States are to negotiate an appropriate country-specific fiscal trajectory, which should take into account the initial situation of each Member State and fulfil various conditions. However, the Council will continue making decisions on the final fiscal requirements based on a proposal from the Commission.

Multiannual fiscal adjustment plans intended to produce sound budgetary positions

Multiannual fiscal adjustment plans setting out the trajectory towards a sound fiscal position are to play a pivotal role in these bilateral agreements. The Commission will assess whether a fiscal position is sufficiently sound on the basis of its debt sustainability analysis. As a rule, the adjustment plans are to span four years. Within this period, Member States are expected to achieve a sound budgetary position. However, they may also request and be granted an extended adjustment period of up to seven years, provided that this is underpinned by a set of reform and investment commitments assessed positively by the Commission. The adjustment plans are intended to ensure that Member States achieve a sound fiscal position by the end of the adjustment period. Furthermore, debt ratios exceeding 60% are to be reduced. If its deficit ratio is above 3% (unless only slightly and temporarily), a Member State is expected to achieve a correction of at least 0.5% of GDP per year (this probably refers to an improvement in the structural deficit).

Commission's debt sustainability analysis as a measure of sound fiscal position

On a country-by-country basis, the Commission determines the fiscal position deemed to be sound and which the country is expected to achieve by the end of the adjustment plan. This is based on its debt sustainability analysis, which itself is founded on numerous assumptions (including longer-term fiscal and economic developments and interest rate assumptions). Using this analysis, the Commission calculates a target for the structural primary balance[25] at the end of the adjustment period that is consistent with a sound fiscal position.[26] The level of the structural primary balance should be sufficiently ambitious to keep the deficit ratio below 3% for a period of ten years after the period covered by the plan. In addition, high debt ratios are expected to be reduced adequately.

Net primary expenditure is key target and control variable

A country-specific fiscal target is then intended to ensure that the Member State in question achieves the aforementioned target for the structural primary balance by the end of the adjustment period. The fiscal target is a cap on the path of net primary expenditure over time. Broadly speaking, net primary expenditure comprises all expenditure apart from interest expenditure and cyclical influences. The term "net" implies that post-adoption adjustments on the revenue side have to be offset via primary expenditure (for example, tax cuts will then lead to a more ambitious expenditure path). The Member State must set the annual targets for net primary expenditure in the adjustment plan in such a way that, based on a realistic fiscal projection, it will achieve the previously determined sound fiscal position. The Member State must not backload the fiscal adjustment effort to the end of the adjustment period. In any case, average growth in net primary expenditure should, a priori, be slower than that in GDP over the medium term (unless the country's debt ratio is below 60%). If an excessive deficit procedure (EDP) is opened during the adjustment period, the Member State concerned must fulfil additional requirements. In that case, it must potentially also adjust the agreed expenditure path.

25 Structural primary balance: the general government fiscal balance is adjusted for cyclical influences, other temporary influences and interest expenditure in relation to GDP.
26 The legislative proposals envisage a secure fiscal position at the end of the adjustment period: the structural primary balance achieved should ensure that, for a ten-year trajectory beyond the plan's horizon, the debt ratio is put on a "plausibly" downward path or stays at "prudent" levels and that the deficit ratio is maintained below 3%, based on the assumption that fiscal policies remain unchanged. Projected changes in ageing-related costs are added to the deficit. Rising ageing-related costs thus increase the deficit requirements. Rules-based adjustments to social security contributions, such as those applied in Germany, will probably not be taken into account.

Rule compliance is measured by net primary expenditure

In principle, whether or not a country complies with the fiscal rule during the adjustment period is measured exclusively by its net primary expenditure path, which would usually be determined at the outset. The Member State must not deviate upward from the agreed expenditure path. By contrast, less favourable developments in other parts of the budget or in medium-term growth are not considered when assessing whether the rule has been met. In other words, in these cases the Member State may fail to meet the agreed objective of a sound budget while still complying with the rule. On the one hand, an expenditure-based rule of this kind has a steadying effect on fiscal policy because the government does not have to react to unexpected developments apart from those in net primary expenditure. As a rule, net primary expenditure is something governments are well able to control. On the other hand, this set-up also accepts that the Member State may fall significantly short of the actual budgetary objective. The projections used to calculate the net primary expenditure path thus play an important role. These should therefore be as accurate as possible and should not regularly have an optimistic bias.

Calculating net primary expenditure is complex

Viewed in more detail, net primary expenditure comprises general government expenditure excluding interest expenditure (hence "primary"). Cyclical unemployment expenditure is likewise excluded. If cyclical deficits or surpluses arise elsewhere as a result of fluctuations in revenue or labour market-related expenditure, they do not need to be corrected. Negative developments are excused, and more positive developments do not result in fiscal discretionary power. In this way, fiscal policy can automatically have a stabilising effect across the economic cycle. In addition, expenditure funded by EU transfers is excluded from net primary expenditure. This means that only nationally-financed expenditure is relevant for fiscal surveillance. Moreover, if, during the adjustment period, a government decides on fiscal measures affecting the revenue side that have not yet been included, this is usually taken into account (hence "net"). For example, if a government raises taxes, this increases the permissible net primary expenditure; if it lowers taxes, less net primary expenditure is permitted.

Regular fiscal surveillance based on adjustment plans

The adjustment plans agreed with the Commission form the basis for regular fiscal surveillance. Member States are to submit annual progress reports during the adjustment period. The Commission will examine these reports and keep track of any deviations from the agreed net primary expenditure path on a notional control account. The legislative proposals do not indicate what has to be done about the shortfalls recorded on this account. However, they are to play a role in decisions regarding the opening of an EDP. If an EDP is to be opened during the adjustment period, no more detailed new agreements need to be made. Moreover, the requirements of the EDP must be taken into account. Towards the end of the adjustment period, Member States will negotiate new adjustment plans with the Commission for the years that follow.

Simplified procedure for countries with low debt levels

A much simpler procedure is to apply for Member States with a deficit ratio below 3% and a debt ratio below 60%. These countries are expected to submit a four-year plan, which the Commission then assesses for plausibility. At the end of the plan, the Member State in question is expected to have reached a target for its structural primary balance. This requirement is intended to ensure that the country maintains its sound fiscal position.

Specific requirements for an EDP

Early warning a preliminary step towards an EDP

EDPs remain linked to the Maastricht criteria of a deficit ratio of 3% or a debt ratio of 60%. As a preliminary step towards an EDP, the Commission can first issue an early warning. This is possible if there is an increased risk that a country's net primary expenditure will increase more than was agreed or if the deficit ratio threatens to rise above 3%. The consequences of such an early warning are unclear, however.

Deficit-based or debt-based EDP

The Commission can initiate an EDP in two cases: if a country's deficit is too high, or if its debt ratio is too high.

Procedure for deficits above 3% of GDP

– As before, a deficit-based EDP is to be opened if the deficit ratio rises above the 3% reference value. In that case, the Member State must, as a rule, correct its fiscal balance by at least 0.5% of GDP per year. This continues to apply until its deficit ratio falls below the 3% reference value. There are exceptions, however. For example, the proposals specify that a temporary breach of the deficit ratio that remains close to the reference value should not lead to the opening of a deficit-based EDP. This was also the case under the existing rules, with deviations of up to 0.5% of GDP and of a maximum of one year being tolerated. It is unclear whether clear quantitative requirements will continue to apply in future.

Procedure for debts above 60% of GDP

– In future, debt-based EDPs are intended primarily to target Member States with a substantial public debt challenge. This means that the Commission can initiate a procedure if the deficit ratio is below 3% but the debt ratio is above 60%. As a rule, a procedure should usually be opened if a Member State with a substantial public debt challenge deviates from the agreed adjustment path for net primary expenditure. However, there is also no clear definition of what constitutes a substantial public debt challenge.[27] The Commission is to conduct a comprehensive assessment of whether or not to open a procedure and to take into account a wide range of country-specific factors.

Financial sanctions

The procedural steps for possible sanctions remain unchanged (such as the procedural steps and the voting rules in the Council). However, the Commission wants to de-constrain the Council's use of sanctions in EDPs. The sanctions are therefore to be set at lower amounts. 0.05% of GDP is to fall due given six months of non-compliance. The sanctions are to be terminated once the Council considers that the Member State has taken effective action. As the sanctions can only be imposed for a maximum of five years, they are limited to 0.5% of a country's GDP per procedure.

Escape clauses may suspend EDPs

EDPs may be suspended if the Council activates one of two escape clauses on the basis of a proposal from the Commission. The general escape clause can be activated in the event of a severe economic downturn in the euro area or in the EU. The country-specific escape clause can be activated in the case of exceptional circumstances outside the control of the government with a major impact on the public finances of an individual Member State.

Further selected aspects of the reform proposals

Adjustment plans can be renegotiated given a change of government, for example

On request, Member States are to be permitted to revise the endorsed adjustment plans before the deadline expires. This is possible, first, if the original path is no longer feasible due to objective circumstances. However, it is unclear what is actually meant by this term. Second, following a change of government, the new government can submit a new adjustment plan. However, the time horizon of the original path is likely to remain unchanged in both cases. By contrast, there is no obligation for a country to amend its adjustment plan if it becomes apparent that it will not meet the target for a sound fiscal position despite following the endorsed net primary expenditure path. If developments in other parts of the budget or in the medium-term growth path are significantly less favourable than previously expected, this is excused under the rules – as long as no EDP is opened.

The role of independent national fiscal institutions is to be expanded. So far, they have primar-

27 This is to be based primarily on the results of the Commission's most recent fiscal sustainability report. However, the Commission does not publish aggregated risk values for the individual countries. Instead, it reports risk values for the short, medium and long term. In some cases, these vary very widely for individual countries. It is unclear what risk value the Commission intends to consider.

Closer involvement of independent national fiscal institutions

ily monitored compliance with national fiscal rules. In future, they will be more closely involved in monitoring compliance with the EU's fiscal rules and will oversee the implementation of national adjustment plans. To this end, they are to assess, for example, their governments' macroeconomic assumptions and fiscal forecasts. If a Member State deviates from the agreed net expenditure path, the fiscal institutions are to analyse the factors relevant to this deviation.

Member States to introduce harmonised accruals accounting

In order to improve the data quality of their statistics, Member States will be required, where appropriate, to fundamentally modernise their national accounts. They are to introduce integrated, comprehensive and nationally harmonised accruals accounting by 2030. This will necessitate coherent accounting rules and procedures as well as integrated data collection and processing systems. Particularly large adjustments would need to be made in Germany, as it currently lacks a harmonised national accounting system. Moreover, the cameralistic accounting system that is still predominantly in use today does not capture revenue and expenditure entirely on an accruals basis.

Assessment

Rules at risk of being weakened

Overall, the Bundesbank considers the Commission's proposals to weaken rather than strengthen the fiscal rules (for specific examples of their weaknesses, see the box on pp. 73 f.). The achievement of a rapid reduction in high debt ratios seems questionable. However, there are also welcome elements to the Commission's proposals. The commitment to sound public finances and the Maastricht criteria set out in the EU Treaty is important (3% deficit and 60% debt ratio). The increased requirements for statistics and the underlying accounting systems are also welcome, for example. Moreover, the close involvement of national fiscal institutions could have a positive impact.

Fewer uniform rules and more bilateral scope for negotiation render rules less binding

The Commission's proposals fail to achieve the objective of making the rules simpler, more transparent and less discretionary, for a number of reasons. First, the proposals envisage fewer uniform fiscal rules and more scope for bilateral negotiations. Second, structural policy objectives are intermingled with fiscal policy objectives and the two are traded off against each other. There is a great deal of scope for interpretation and discretion. This threatens to reduce the binding effect of the fiscal rules even further.

Clear requirements for structural budget balances replaced by complex targets derived from assumption-driven sustainability calculations

The current objective of close-to-balance structural budgetary positions, which is relatively transparent for all Member States, is to be removed and replaced by new country-specific targets, which are mainly derived from complex and highly assumption-driven sustainability calculations. Furthermore, reform and investment projects are to be incorporated into the country-specific fiscal requirements, potentially by extending the adjustment period significantly.

Calculating net primary expenditure not straightforward; substantial deviations from sound fiscal position a risk in the medium term

Calculating net primary expenditure, a central reference point for monitoring the rules, is not straightforward either. This, in turn, relies on a number of assumptions and estimates, including with regard to changes in tax law and medium-term growth. All of this is fraught with high uncertainty. In the past, growth rates and the additional revenue generated by tax increases have often been overestimated. Given such overly optimistic estimates, a country may fail to meet the structural primary balance target at the end of the adjustment period even though it is following the endorsed net primary expenditure path. As such inaccurate assessments can build up over a period of up to seven years, the fiscal position achieved at the end of the adjustment period may sometimes deviate significantly from the agreed level. This means, for example, that it is impossible to rule out the possibility that, while still complying with the rules, a country's structural deficit or debt ratio will rise significantly over an extended period of time. It would only be possible to open an EDP if a country exceeded the 3% deficit limit.

Examples of weaknesses in the reform proposals and more stringent design options

This box outlines examples of individual weaknesses identified in the reform proposals. For each weakness, alternative design options are given that could be used to selectively apply the rules more stringently. It would also be crucial to limit the substantial discretionary leeway inherent in the rules, amongst other things.

- The proposals envisage the Member States being able to extend the adjustment period if they commit to appropriate reforms and investment. This is likely to significantly reduce the required degree of annual adjustment towards a sound fiscal position, in some cases. However, the impact of reforms and investment on growth is generally highly uncertain and often subject to debate. Any expected positive effects of the reforms are already taken into account in the projections and sustainability calculations anyway. This option should therefore be removed and the adjustment period limited to a maximum of four years across the board.

- The agreed target for a Member State's structural primary balance at the end of the adjustment period may not be ambitious enough to guarantee an adequate safety buffer against an excessive deficit. However, the requirements should ensure that there is a sufficient safety buffer in place that takes account of potential cyclical fluctuations. With this aim in mind, a new design option could use, as a starting point, the European Commission's existing approach based on minimum benchmarks, which is also intended to prevent excessive deficits.

- The planned rules do not adequately ensure a genuine improvement in Member States' fiscal positions. A country's structural primary balance may still deteriorate significantly even if it adheres to the agreed adjustment path. This may occur if, for example, revenue developments are structurally weaker than was assumed in the adjustment plan. If this is the case, a new adjustment plan should be drawn up at an early stage in order to at least prevent a Member State from moving away from a sound fiscal position.

- Where a highly indebted country deviates from the adjustment path, the reform proposals do not clearly state that this will lead to the opening of a debt-based excessive deficit procedure (EDP). This is likely to be at the European Commission's discretion, first and foremost. It would be better to automatically open a debt-based EDP as from a certain debt ratio in the event that a country fails to adhere to its net primary expenditure path (e.g. above 90%).

- The reform proposals do not clearly specify the requirements that a country must fulfil in a debt-based EDP. The adjustment path in a debt-based EDP should ensure a reliable and marked fall in the debt ratio. In any case, the country should be obliged to return to its previously agreed net primary expenditure path.

- The proposals specify that a temporary breach of the 3% deficit ratio that remains close to the reference value should not lead to the opening of a deficit-based EDP. The wording of this exception

to the rules is vague and leaves room for interpretation. It would be preferable to always open a deficit-based EDP when a country's deficit ratio reaches 3.5% of GDP or is expected to exceed the 3% ceiling for longer than one year. This is also the approach that has been taken up to now.

– It is unclear whether a new adjustment plan has to be drawn up when an EDP is opened. In order to keep a constant eye on sustainability, a new adjustment plan (generally with a timeframe of four years) should be drawn up every time an EDP is opened, setting out a binding path towards a sound fiscal position at the end of the adjustment period.

– The EU's NextGenerationEU programme (NGEU), which was launched during the pandemic, entails joint borrowing at the EU level to finance grants, inter alia. These debts ultimately weigh on the Member States, as they have to repay them just like national debt. However, the reform proposals do not take these joint EU debts into account. The corresponding future burdens on Member States should be considered in the fiscal rules. This applies not only to the NGEU, but also to any further debt incurred jointly at the EU level in future (although it is enshrined in law that such joint debts are only possible in exceptional cases). Crucially, Eurostat should also report EU-level borrowing in line with the Maastricht requirements for government debt. These joint EU debts could be allocated to each Member State according to its share in the EU's gross national income (not as part of the national accounts, but rather with respect to the debt ratios upon which the rules are based).

Binding effect of rules weakened by their complexity and lack of clarity

The derivation of country-specific fiscal targets is likely to be difficult for the general public to understand. The same is true of decisions about whether a country has complied with the rules: there are numerous exemptions and discretionary powers, making it unclear when Member States will be deemed to have failed to meet the requirements and what the consequences will be. In addition, Member States can renegotiate their adjustment plans. Moreover, they are under no obligation to respond if they fail to meet the requirements. All of this means that the rules can be interpreted loosely and thus no longer provide clear guide rails for national governments, independent fiscal institutions and the general public. This weakens their binding effect.

With its widerange of policy tasks, Commission not well suited to role of monitoring body

In the area of fiscal surveillance, the proposals allow the Commission even more leeway than before to interpret the rules in different ways. The Commission has a wide range of tasks and pursues other aims in addition to fiscal objectives. This will inevitably lead to conflicts of interest and weaken the focus of the fiscal rules on sound public finances. This raises the question of whether the Commission is well suited to a pivotal role in implementing and monitoring fiscal rules.

Greater national ownership

The reform proposals aim to give Member States more national ownership of their fiscal path. In this respect, they make the fiscal rules more flexible. This makes it all the more important for Member States to remain responsible for independently maintaining the confidence of capital markets and limiting risk premiums on their financing costs.

Adjustments still possible during ongoing negotiations

The Commission's legislative proposals are still under negotiation among the Member States and may yet be amended. Germany's Federal Minister of Finance has indicated that he feels improvements are needed.

List of references

CDU and SPD Berlin (2023), Das Beste für Berlin, coalition agreement 2023-2026.

Deutsche Bundesbank (2023), Public finances, Monthly Report, February 2023, pp. 64-80.

Deutsche Bundesbank (2022a), Inflation-induced bracket creep in the income tax scale, Monthly Report, June 2022, pp. 63-73.

Deutsche Bundesbank (2022b), Central government's debt brake: options for stability-oriented further development, Monthly Report, April 2022, pp. 49-66.

Deutsche Bundesbank (2022c), Pension insurance scheme: long-term scenarios and reform options, Monthly Report, June 2022, pp. 47-61.

Deutsche Bundesbank (2021a), Federal debt: allocate premia on accruals basis in budgetary interest expenditure, Monthly Report, June 2021, pp. 47-51.

Deutsche Bundesbank (2021b), Bundesbank contribution to the public debate on the review of the EU economic governance (October to December 2021), http://www.bundesbank.de/content/884870, December 2021.

Federal Ministry of Finance (2023), Aktuelle Wirtschafts- und Finanzlage, Monthly Report, April 2023, pp. 37-71.

Independent Advisory Board of the Stability Council (2023), 20. Stellungnahme zur Einhaltung der Obergrenze für das strukturelle gesamtstaatliche Finanzierungsdefizit nach § 51 Absatz 2 HGrG, May 2023.

Stability Council (2022), Beschluss zur Einhaltung der Obergrenze des strukturellen gesamtstaatlichen Finanzierungsdefizits nach § 51 Absatz 2 des Haushaltsgrundsätzegesetzes gemäß § 7 Stabilitätsratsgesetz, December 2022.