German Stability Programme 2024

Federal Ministry of Finance

Stabilität

German Stability Programme 2024

2024 Update

Contents

Preface to the German Stability Programme for 2024 5

1. Summary 6

2. Aggregate economic conditions in Germany 9

2.1 Aggregate economic conditions in Germany in 2023 9

2.2 Short- and medium-term outlook for the aggregate economy, 2024–2028 9

3. German fiscal policy in the European context 12

3.1 EU fiscal policy rules and their implementation in Germany 12

3.2 Fiscal situation and strategic direction 14

3.3 Fiscal policy measures in terms of expenditure and revenue 19

3.4 Implementation of country-specific fiscal policy recommendations 34

4. General government budget balance and debt level projection 36

4.1 Trends in general government revenue and expenditure 36

4.2 Trends in the government budget balance 38

4.3 Trends in the general government structural balance 38

4.4 Sensitivity of the budget balance projection 40

4.5 Trends in debt levels 41

5. Long-term sustainability and quality of public finances 42

5.1 Challenges to the sustainability of public finances 42

5.2 Government revenue and expenditure from a long-term perspective 44

5.3 Measures to ensure long-term fiscal sustainability 45

5.4 Measures to increase the effectiveness and efficiency of public revenues and spending 51

Tables

Table 1: Trends in the government revenue ratio 36
Table 2: Trends in the government expenditure ratio 37
Table 3: Trends in the general government budget balance 38
Table 4: Budget balances according to government level 38
Table 5: Structural budget balance compared with actual budget balance and GDP trend 39
Table 6: Expenditure benchmark: projected expenditure and potential output 40
Table 7a: GDP sensitivity of the general government budget balance projection 40
Table 7b: Interest rate sensitivity of the general government budget balance projection 41
Table 8: Trends in the general government debt-to-GDP ratio 41
Table 9: Macroeconomic prospects 53
Table 10: Price trends – deflators 54
Table 11: Labour market trends 54
Table 12: Sectoral balances 55
Table 13: General government budgetary prospects 55
Table 14: No-policy change projections 56
Table 15: Amounts to be excluded from the expenditure benchmark 57
Table 16: Discretionary measures at the general government level (including discretionary measures at the federal level) 57
Table 17: General government debt developments (Maastricht debt ratio) 58
Table 18: Cyclical developments 58
Table 19: Divergence from previous update 59
Table 20: Long-term trends in age-related general government expenditure 59
Table 21: Impact of the Recovery and Resilience Facility (RRF) on the projection – grants 60
Table 22: Technical assumptions 61
Table 23: Contingent liabilities 61

Figures

Figure 1: Gross domestic product, in real terms 11
Figure 2: Labour market trends in Germany 11
Figure 3: Comparison of structural and actual fiscal balance (in % of GDP) 13
Figure 4: The Federation’s structural net borrowing (in % of GDP) 16
Figure 5: General government revenue and expenditure structure in 2023 33
Figure 6: Demographic trends in Germany 43
Figure 7: Trend in German potential output, 2015–2028 43

Preface to the German Stability Programme for 2024

The member states of the European Union submit their medium-term fiscal plans to the European Commission and to the Economic and Financial Affairs Council (ECOFIN) by the end of April each year. To this end, in order to comply with the rules of the Stability and Growth Pact that applied at the time of this update, member states of the euro area submit updated Stability Programmes, while all other EU member states submit updated Convergence Programmes. On 10 February 2024, the EU member states and the European Parliament reached preliminary political agreement on a reform of the SGP. The revised legal provisions of the SGP reform have not yet entered into force. Under the new rules, member states will set out their fiscal and economic policies in the form of a medium-term fiscal-structural plan (FSP) as well as an annual progress report. Once the new rules enter into force, the federal government will provide a comprehensive account of Germany's fiscal policy when it submits its 2024 FSP.

By submitting this updated Stability Programme, which contains projections of budgetary trends at all government levels (Federation, *Länder*, local authorities and social security funds), the federal government is complying in full with its obligation for the year 2024 to submit national medium-term fiscal plans in accordance with Article 4 of Regulation (EU) No 473/2013 on the provisions for monitoring and assessing draft budgetary plans. The programme follows the *Guidelines on the format and content of Stability and Convergence Programmes* (Code of Conduct).

The projection of budgetary trends at all government levels contained in the Stability Programme is based on the 2024 federal budget of 12 February 2024, the federal government's annual projection on macroeconomic trends of 21 February 2024, the results of the Working Party on Tax Revenue Estimates of 26 October 2023 and the fiscal plan to 2027 that was issued on 5 July 2023. The reference date for the projection is 28 March 2024.[1]

This update of the German Stability Programme was approved by the federal cabinet on 24 April 2024. The federal government submits the update of the German Stability Programme to the competent expert committees of the German Bundestag as well as to the Finance Minister Conference (*Finanzministerkonferenz*) and the Stability Council (*Stabilitätsrat*). After review by the ECOFIN Council, the Council's opinion on the Stability Programme is likewise forwarded to these bodies.

The Federal Ministry of Finance publishes the updated Stability Programme along with the programmes for preceding years online at:

https://www.bundesfinanzministerium.de

The programmes of all EU member states, corresponding analyses by the European Commission and the recommendations of the ECOFIN Council are published on the European Commission's website:

https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/stability-and-convergence-programmes_en

1 New measures and programmes are financed within the existing budget appropriations or establishment plans of the relevant departmental budgets. The inclusion of measures in the Stability Programme does not prejudice current or future budget negotiations.

1. Summary

In spring 2024, Germany's fiscal policy is geared towards a return to normality and towards strengthening the sustainability of public finances and the efficiency of public spending, whilst at the same time maintaining the high level of investment spending to ensure that Germany is ready for the future. The constitutional debt brake, as a key component of German fiscal policy, will allow Germany to reach these objectives by requiring the government to set spending priorities in a continuous manner and by ensuring a return to the expenditure path of the years before the overlapping crises. The fiscal policy normalisation in 2024, which is characterised by prudent and forward-looking fiscal policies, will open up additional fiscal space. In this way, the federal government is supporting the European Central Bank's monetary policy, which aims to curb inflation.

The fiscal situation in early 2024 is shaped by the ongoing macroeconomic impact of Russia's war of aggression against Ukraine and by the increasing medium- and long-term structural challenges facing the German economy. In 2023, despite declining wholesale energy prices, households and businesses continued to be burdened by the extraordinary situation on German and European energy markets resulting from Russia's illegal war of aggression. Consequently, the federal government continued its energy price-related support measures in 2023, but allowed them to expire when end user prices for energy declined over the course of the year. The main energy price-related support measures were the price brakes for electricity, gas and heating, adapted flexibly to contractually agreed end user prices and contained energy savings incentives. These price brakes expired at the end of 2023. The federal government took advantage of the decline in end user prices and the discontinuation of the energy price-related support measures to reduce the projected public deficit, in line with the country-specific recommendations.

The projected macroeconomic trends for 2024 and subsequent years reflect the structural challenges facing the German economy. This applies in particular to demographic change, which will contribute significantly to the projected negative effect of the volume of labour on the German economy's growth potential from 2026 onwards. Demographic change, decarbonisation, low productivity growth (partly related to untapped digitalisation potential) and structural changes in world trade as a result of geopolitical shifts can dampen growth while simultaneously creating price pressure. To address these challenges successfully, the federal government is pursuing a comprehensive and targeted supply-side policy that supports the economy's transformation and aims to boost Germany's growth potential. In the current macroeconomic environment, which is characterised by real scarcities (e.g. skills shortages), the best way to achieve this is to boost productivity. In particular, a successful supply-side policy requires the mobilisation of private-sector investment, alongside measures to strengthen labour supply and skills. The federal government has therefore set itself the goal of creating an innovation-friendly environment with a competitive tax system, modernising the public administration and accelerating planning and approval procedures. It has already provided key stimuli as part of a comprehensive and targeted supply-side policy that supports the economy's transformation. With the Financing for the Future Act (*Zukunftsfinanzierungsgesetz*), it is strengthening conditions for innovative high-growth companies in particular by improving the availability of private capital for investment and by making it easier for young companies

and start-ups to access venture capital. The Growth Opportunities Act (*Wachstumschancengesetz*) creates targeted tax incentives for investment and innovation, simplifies the tax system and eases the bureaucratic burden on companies. As part of the electricity price package, the implementation and temporary expansion of the cut in electricity duty for manufacturing companies as well as agriculture and forestry businesses to €0.5 per MWh, the lowest rate permitted by the European Union, boosts the competitiveness of the manufacturing industry in line with supply-side policy as a key pillar of Germany's strategic fiscal policy focus. Building on the supply-side policy agenda, which is set out in detail in the federal government's 2024 Annual Economic Report, further measures to boost economic momentum will be necessary in order to stabilise and reverse the negative trend in potential growth in the face of major structural challenges.

As an important step towards improving conditions for businesses, the federal government is working towards reducing the duration of planning and approval procedures in Germany. Another key factor is the productivity-enhancing potential of digitalisation, which also plays a major role when it comes to modern administration, technological advances and hence long-term economic growth. This is also why, alongside the digitalisation of the economy, infrastructure and education, one of the priorities of the German Recovery and Resilience Plan (DARP) is to modernise the public administration and reduce barriers to investment. The federal government will continue to strengthen the German economy's competitiveness. Among other things, it has proposed the draft Bureaucracy Relief Act IV (*Bürokratieentlastungsgesetz IV*), which will provide further relief to businesses, the administration and citizens.

With the aim of increasing the supply of labour, the federal government is providing targeted stimuli with regard to tax, labour market, education and family policy in order to strengthen incentives for employment, continuing education and skilled labour immigration. The federal government has adopted the Act on the Further Development of Skilled Immigration (*Gesetz zur Weiterentwicklung der Fachkräfteeinwanderung*) as well as a corresponding ordinance. These provisions significantly simplify skilled labour immigration from non-EU countries. Partly in order to meet the existing urgent demand for skilled workers, the federal government has improved refugees' access to the labour market by launching the "job turbo" plan of action, which is designed to ensure the quick and sustainable integration of refugees into the labour market. The Initial and Continuing Education and Training Act (*Gesetz zur Stärkung der Aus- und Weiterbildungsförderung*) has the aim of strengthening continuing education and training in order to prevent unemployment caused by structural change and maintain the supply of skilled labour. These measures will also contribute to enhancing the competitiveness of the German economy, boost productivity growth, and support the expansion of the labour factor in the face of increasing labour shortages, which in turn will promote strong and sustained economic growth. Furthermore, it will be crucial in the future to make even better use of the domestic labour supply, alongside efforts to boost skilled labour immigration. In this way, a supply-side policy strengthens the sustainability of public finances and secures Germany's future prosperity.

The federal government continues to prioritise the future-oriented areas of education, science and research, because the skilling of future employees and the economic innovation process play key roles in advancing labour productivity. The Federal Ministry of Education and Research (departmental budget 30) has a total of €21.5bn at its disposal in 2024, as it did last year. To increase labour force participation, the federal government is also implementing further structural improvements in the quality of childcare and education provision. For this purpose, the federal government will provide the *Länder* with around €4bn in additional funding in 2024 under the Child Daycare Quality Act (*KiTa-Qualitätsgesetz*).

Maintaining the sustainability of public finances is a further strategic objective of German fiscal policy. In order to safeguard fiscal capacity in future crises and in view of the major challenges facing the German economy in the medium and long term, the 2024 Stability Programme marks a normalisation of fiscal policy. Compliance with the regular borrowing limit under Germany's debt brake in 2024 signals the reliability and soundness of German fiscal policy. In subsequent years, too, the federal government will continue on the course of consistent quantitative consolidation, complemented by increased qualitative consolidation and more efficient and outcome-oriented public spending. This will secure fiscal space for the future and maintain the very high level of investment spending of around €53bn in the 2024 federal budget (excluding special factors). For 2024, a total of around €49.1bn has been earmarked in the Climate and Transformation Fund for the mobilisation of private investment and other measures to promote the climate-neutral transformation. By focusing on investment, the federal government is taking steps to increase potential output and boost economic growth, which is currently weak. The federal government is continuing on its course of investing in a modern, digital and climate-neutral Germany. It is also consistently working towards boosting Germany's overall defence capability, and strengthening the long-term sustainability of public finances with an efficient and forward-looking fiscal policy. This is vital to ensure public and business confidence in the state's ability to take effective action.

The gradual return to fiscal normality is also reflected in the forecast for public finances, which anticipates a gradual reduction of the general government deficit in 2024 and 2025 to 1% of GDP. This is being achieved primarily through structural consolidation. In line with Germany's strategic fiscal policy focus, the structural deficit will also see a gradual decline in 2024 and 2025 to ¾% of GDP. This projected improvement is consistent with a moderately restrictive fiscal stance, which is in line with the EU recommendations. The structural consolidation will also result in a reduction of the debt-to-GDP ratio. Following a slight increase in 2024, the debt-to-GDP ratio will gradually decline to 62% by the end of the projection period. The projected trends reflect the federal government's prudent fiscal policies and the aims of maintaining fiscal resilience, strengthening the sustainability of public finances and building fiscal buffers.

The Federal Ministry of Finance's current long-term projections indicate that fiscal sustainability has worsened compared with previous projections from 2020. Under the simplistic assumption of a no-policy-change scenario, the projections indicate that action will need to be taken. Demographic change is one of the main challenges to the long-term sustainability of public finances. The federal government is meeting this challenge with measures to improve the performance potential of the working population, increase investments and productivity, and financially strengthen the social security system. A solid fiscal foundation is needed to deal with the demographic trend towards an ageing population. It is therefore important that the federal government returns to compliance with the constitutional debt brake in 2024. The federal government plans to build up a fund that will enable the statutory pension insurance system to be financed in part through investments in capital markets (alongside contributions and federal government payments) in order to stabilise the contribution rate over the long term. In order to ensure the long-term sustainability of public finances, government revenue and spending are reviewed regularly to assess their effectiveness and efficiency. To create additional fiscal space, further steps need to be taken to make public budgets more target- and results-driven. The federal government has also set itself the task of eliminating subsidies and spending that are ineffective or detrimental to the environment and the climate.

2. Aggregate economic conditions in Germany

2.1 Aggregate economic conditions in Germany in 2023

Although the German economy proved to be fundamentally resilient during the energy price crisis, high inflation and the resulting marked increase in interest rates slowed domestic demand significantly in 2023. Foreign demand was also sluggish. The elevated reported sickness rates compared with pre-2022 years placed an additional burden on the economy. However, the labour market remained relatively robust despite the weak economy, with a rise in employment, but also a slight uptick in unemployment. Overall, real GDP contracted by 0.3% on the year in 2023.

In terms of gross value added, 2023 saw contrasting trends in different sectors: Manufacturing declined at a similar rate as GDP in real terms (down by 0.4%), with positive momentum coming primarily from the automotive industry and other vehicle construction. Output and value added in energy-intensive sectors such as the chemicals and metal industries declined once again, having already experienced a sharp drop in 2022. The construction industry recorded slight growth overall (up by 0.2%), thanks to gains in civil engineering and the finishing trades. However, building construction was strongly impacted by rising financing and construction costs and thus posted a significant decline. In contrast, most services sectors were able to increase their value added and thus boost economic growth in 2023.

Consumer price inflation slowed noticeably over the course of 2023, largely as a result of substantial declines in energy prices. The inflation rate stood at 8.7% in January 2023, but fell back to 3.7% by the end of the year. On average, consumer prices were 5.9% higher in 2023 than in the previous year.

2.2 Short- and medium-term outlook for the aggregate economy, 2024–2028

Many of the adverse factors that weighed on the economy in 2023, especially the political uncertainties, persist at the beginning of 2024. As a result, the German economy is still in troubled waters. Sentiment indicators have improved, but remain at a low level. It is assumed that overall economic momentum was still relatively weak in early 2024. However, some of the negative factors that affected the economy last year, such as high consumer price inflation and the resulting drops in purchasing power, have subsided significantly. Low inflation, marked increases in salaries and a fundamentally robust labour market are expected to lead to a rise in real incomes. It is therefore anticipated that the overall economy will gradually experience a moderate recovery over the course of 2024, primarily driven by private consumption. However, the level of uncertainty surrounding economic forecasts remains high. There are downwards risks arising from geopolitical factors in particular.

In March, the inflation rate (measured by consumer price index, or CPI) stood at 2.2%. However, core inflation (which excludes the prices of energy and food) and, in particular, services inflation were still above 3%. Moreover, the temporary VAT rate cut on gas and district heating is due to expire in April, and the inflation-lowering base effect from the introduction of the *Deutschlandticket* (a local and regional public transport ticket that is valid throughout Germany) will cease to apply in May. Both of these changes could affect the inflation rate in the coming two months. Next year, the average annual inflation rate is forecast to be slightly

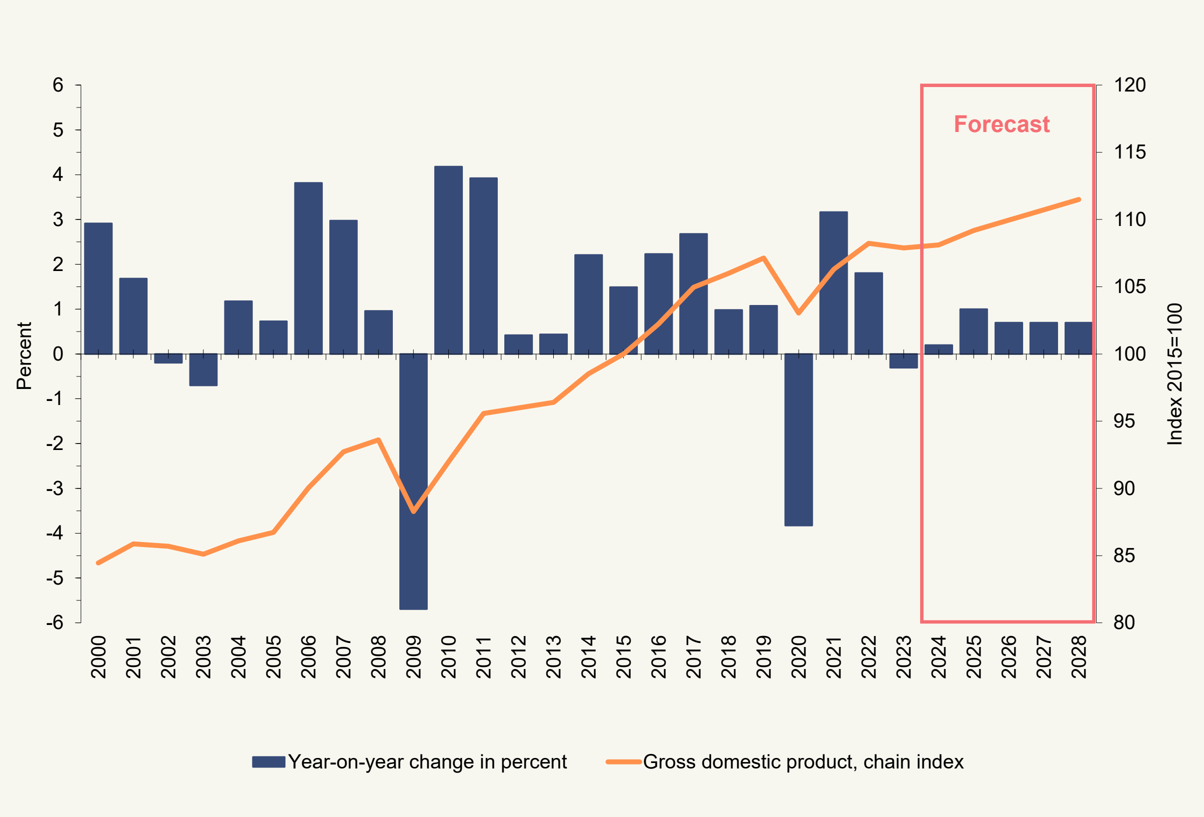
below the 2% target, according to the federal government's annual projection.

On the labour market, the number of people in employment is expected to continue to rise in 2024 and 2025 from a historic high of nearly 46 million in 2023, although demographic change will increasingly slow this trend. As the economy recovers over the course of 2024, unemployment is also likely to turn the corner, although the annual average for 2024 is forecast to remain slightly above last year's level due to the carry-over effect from 2023. Annual average unemployment is projected to decline in 2025.

In its annual projection, which was published on 23 February 2024, the federal government forecasts overall economic growth of 0.2% in 2024 and 1.0% in 2025. In the subsequent three years, the federal government anticipates growth of 0.7% per year. According to the annual projection, overall potential output will grow by 0.6% in 2024 and by 0.5% in 2025. Productivity growth in particular is forecast to lag significantly behind the historical average during this period. By the end of the projection period in 2028, potential output growth is expected to stand at 0.5%. The trend in potential output will be influenced by labour's declining (and, in the medium term, negative) contribution to growth, reflecting the mounting shortages of skilled labour caused by demographic change. In contrast, the contributions of capital and productivity to growth will remain constant or increase slightly. Alongside a rise in skilled labour immigration and higher rates of labour force participation among women, older people, unemployed people and immigrants, boosting productivity will play an increasingly important role for the German economy's medium-term growth prospects. Due to the subdued level of economic growth anticipated in 2024, the negative output gap is projected to widen to approximately 1.2% of potential output, meaning that aggregate production capacity will be underutilised. As the economy recovers in 2025, the output gap will narrow to 0.7% of potential output, putting it somewhat closer to the normal range of capacity utilisation (+/- 0.5%).

Gross domestic product, in real terms

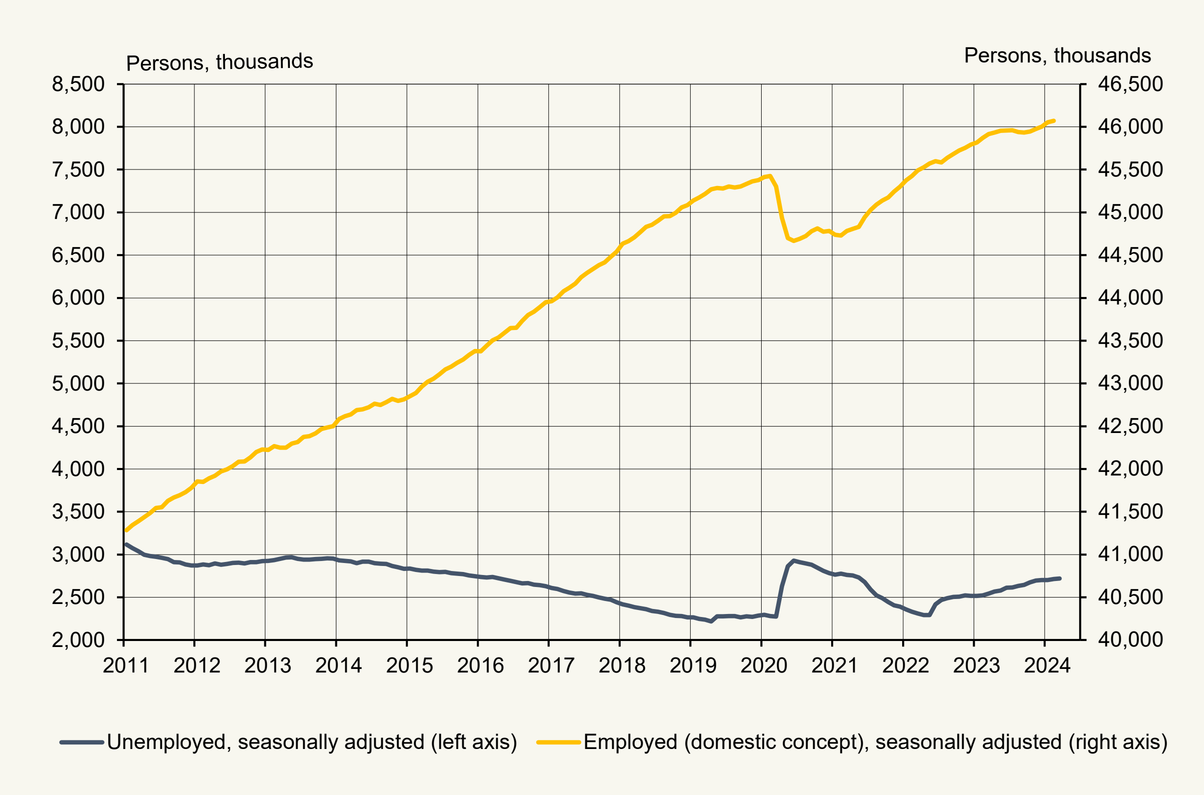
Figure 1



Sources: 2000–2022: Federal Statistical Office; 2023-2028: federal government, 2024 annual projection, February 2024

Labour market trends in Germany

Figure 2



Sources: Federal Employment Agency, Federal Statistical Office, March 2024

3. German fiscal policy in the European context

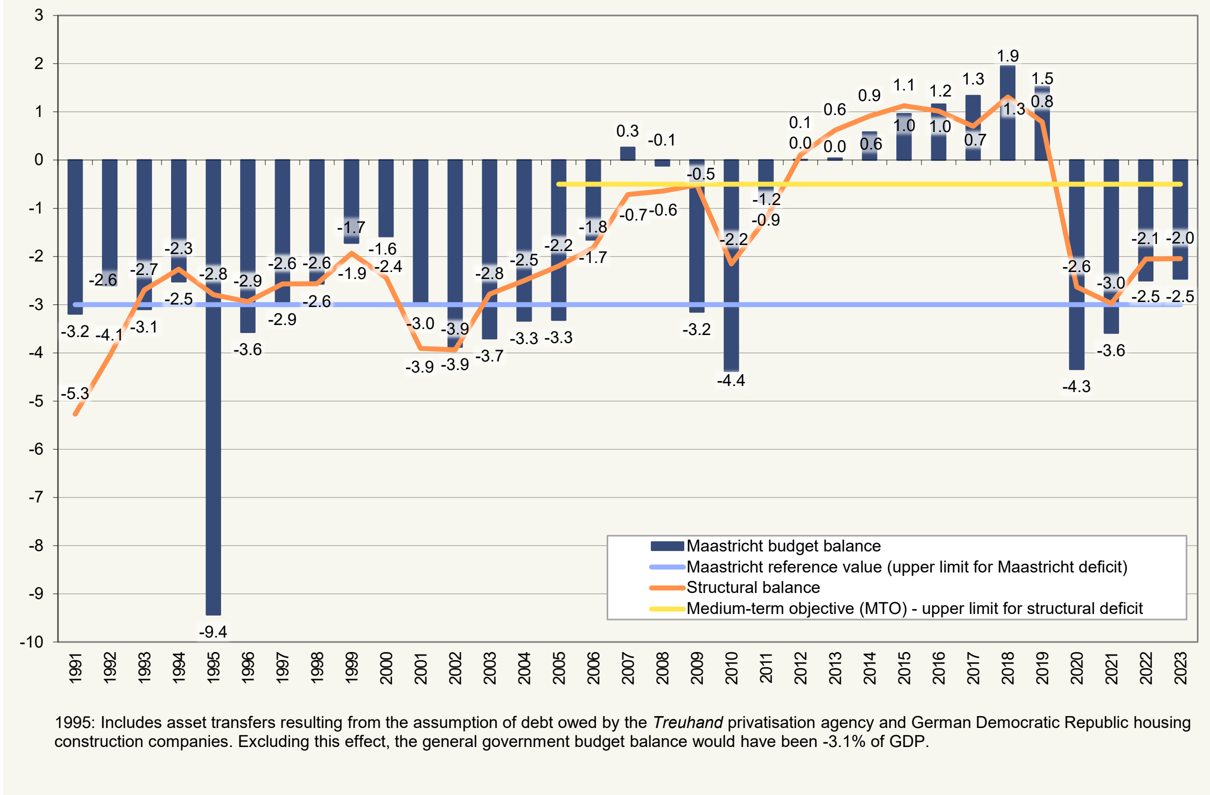
3.1 EU fiscal policy rules and their implementation in Germany

On the whole, the economies of the EU member states have shown resilience in the face of the energy price shock triggered by Russia's ongoing war of aggression against Ukraine, which began on 24 February 2022. However, the economic burdens and fundamental changes in the macroeconomic environment continue to pose a major challenge for European economic and fiscal policy. It is in part thanks to the swift, comprehensive and coordinated response that the impact of higher living costs, weak foreign demand and tighter monetary policy in 2023, the effects of which are gradually being felt, is not taking a heavier toll on the European economy. In light of this, as well as the expected economic recovery in Europe in 2024 and a further decline in inflation rates, the general escape clause of the EU fiscal framework has been deactivated since the end of 2023. This is because the conditions for activating the escape clause – a severe economic downturn in the euro area or the EU as a whole – no longer apply. The European economy has recovered beyond its pre-pandemic level of economic output and has weathered the acute phase of the energy price shock despite continued uncertainty. Consequently, procedures under the EU fiscal framework are returning to differentiated and quantitative country-specific recommendations. In spring 2024, the European Commission intends to review the initiation of deficit procedures on the basis of the actual data for 2023.

The fiscal policy Germany is pursuing in 2024 is in line with the deactivation of the general escape clause at the end of 2023.
After four exceptional, crisis-ridden years, the federal budget for 2024 adopted by the German Bundestag on 2 February 2024 once again complies with the regular borrowing limit under the debt brake that is enshrined in Germany's constitution. The 2024 federal budget thus marks a normalisation of fiscal policy. The return to the regular borrowing limit in 2024 clearly signals the reliability and soundness of German fiscal policy. In this way, the federal government is ensuring the sustainability of Germany's public finances and the government's capacity to address the medium-term challenges facing the German economy, taking into account the European guidelines for budgetary policy, and is avoiding additional inflationary pressure. By setting spending priorities in a consistent and continuous manner, the federal government is maintaining the very high level of investment spending of around €53bn in the 2024 federal budget (excluding special factors) in line with the country-specific recommendations and providing a strong stimulus for a modern, digital and climate-neutral Germany. The federal government's fiscal plan to 2027 continues this stability-oriented approach and reaffirms the normalisation of fiscal policy that has been achieved in the 2024 federal budget.

Comparison of structural and actual fiscal balance (in % of GDP)

Figure 3



Source: Federal Statistical Office, February 2024

Despite the measures that were necessary in 2023 to mitigate the effects of high energy prices and stabilise the economy in the face of the ongoing burdens caused by Russia's invasion of Ukraine, the budget balance in relation to GDP remained unchanged from 2022, when Germany complied with the Maastricht deficit limit for the first time since 2019. The general government fiscal balance (encompassing the Federation, *Länder*, local authorities and social security funds, including their respective off-budget entities) stood at -2.5%[2] of GDP in 2023. As shown in Figure 3, the general government recorded a structural deficit of 2.0% of GDP in 2023.

Germany's debt-to-GDP ratio fell considerably to 63.6% in 2023 (from 66.3% in 2022) and thus remained above the 60% upper limit. In 2019, Germany's debt-to-GDP ratio fell to 59.6%, its lowest level in many years. General government budget surpluses and sustained economic growth during the preceding years had contributed significantly to achieving this low level. It was mainly thanks to this that Germany had a large amount of fiscal space to fall back on in the past four years, when quick and decisive fiscal policy action was required in order to tackle two crises in quick succession.

2 The fiscal balance for 2023 was adjusted on 22 April 2024 as a result of a statistical revision. The revision was due to methodological adjustments rather than any changes in the economic situation. It has no relevant impact on Germany's fiscal policy in 2024.

3.2 Fiscal situation and strategic direction

According to the conclusions of the ECOFIN Council deliberations of 16 January 2024 on the Annual Sustainable Growth Strategy for 2024, the member states agreed upon the following priorities and recommendations:

"[…] that while policies should remain agile in view of the prevailing uncertainty, an overall restrictive fiscal policy stance in 2024 is appropriate to enhance public finance sustainability and in order to avoid fuelling inflationary pressures, […] that remaining emergency energy support measures should be phased out as soon as possible in 2024 and the related savings should be used to reduce government deficits, […] that the fiscal policy strategy should be aimed at strengthening fiscal sustainability, rebuilding fiscal buffers, delivering higher sustainable growth and boosting EU resilience to future challenges, […] that public investment [should make] a significant contribution to reinforcing the EU's competitiveness, […] that [there is a] need to continue pursuing ambitious structural reforms and productive investment, including in common priorities, such as green and digital transition, energy security, strengthening productivity and resilience, as well as defence capabilities, […] that [there is a] need to further improve framework conditions for boosting private investment and productivity […]."

The federal government is taking these guidelines into account in its fiscal stance and strategic direction. The fiscal situation in early 2024 is shaped by the short-term challenges presented by the ongoing macroeconomic impact of Russia's war of aggression against Ukraine and increasingly by the medium- and long-term structural challenges facing the German economy. In this environment, fiscal policy at the start of 2024 is geared towards a normalisation and towards strengthening the sustainability of public finances and the efficiency of public spending whilst at the same time maintaining the high level of investment spending to ensure that Germany is ready for the future. Accordingly, Germany's moderately restrictive fiscal stance in 2024 is in line with the Council conclusions on the Annual Sustainable Growth Strategy for 2024 and supports the European Central Bank's monetary policy, which aims to curb inflation.

In 2022, in order to temporarily cushion the economic and social impacts that dramatic increases in energy prices had on individuals and businesses, the federal government quickly implemented targeted and – given that a wide range of households and businesses were affected – suitably broad-based measures for 2022 and 2023 to stabilise incomes and preserve the productive capacity of the German economy. The federal government also took decisive action in 2023 to address the consequences of Russia's war of aggression in the areas of national and alliance defence by launching a "turning point" in German security policy; providing support for Ukraine; receiving, providing services for and integrating refugees from Ukraine; and securing Germany's energy supply. The federal government ensured financing for these extraordinary crisis-related expenditures in 2023 through the Economic Stabilisation Fund (Energy) and the 2023 federal budget. In 2023, price brakes for electricity, gas and heating – which were financed through the Economic Stabilisation Fund (Energy), adapted flexibly to contractually agreed end user prices and were outfitted with powerful energy savings incentives – constituted key measures

implemented by the federal government to provide targeted support to households and businesses particularly hard hit by high prices. The continuation of these measures in 2023 is also laid down in the European Commission's fiscal policy guidance, which provides for the use of targeted fiscal policy measures where necessary in order to cushion the effects of high energy prices.

Towards the end of 2023, it became necessary to make extensive adjustments to the 2023 federal budget and to the draft budget for 2024. In its judgment of 15 November 2023 (2 BvF 1/22), the Federal Constitutional Court declared the Act Adopting a Second Supplement to the Federal Budget for the 2021 Fiscal Year (*Gesetz über die Feststellung des Zweiten Nachtrags zum Bundeshaushaltsplan für das Haushaltsjahr 2021*) to be void. Among other things, the court found that the chronological decoupling of (a) the declaration of an unusual emergency situation that is beyond government control and that places the state's fiscal capacity at substantial risk (as per Article 115 (2) sentence 6 of the Basic Law) from (b) the actual use of the borrowing authorisations precipitated by this unusual emergency situation, is incompatible with the constitutional principles of yearly budgeting (*Jährlichkeit*) and annuality (*Jährigkeit*). The 2023 supplementary budget remedied the repercussions resulting from the voiding of the Second Supplementary Budget Act 2021 and applied the court judgment's criteria to the 2023 federal budget as well as to the economic plans for various special funds set out in the 2023 federal budget. This established legal certainty. The German Bundestag adopted the supplementary budget on 15 December 2023 and, in so doing, also made the necessary adjustments to the 2023 economic plan for the Climate and Transformation Fund. The fund's reserves were reduced by €60bn. In tandem, the 2023 Budget Financing Act (*Haushaltsfinanzierungsgesetz 2023*) authorised the Economic Stabilisation Fund (Energy) to borrow €43.2bn in 2023.

The federal budget recorded net borrowing of approximately €27.2bn in the 2023 budget year. This means that the 2023 federal budget signals a fiscal policy turnaround following net borrowing levels of well over €100bn in the years from 2020 to 2022. After taking into account (a) the net borrowing of the Economic Stabilisation Fund (Energy), (b) the balance of financial transactions and (c) the cyclical component as adjusted for actual economic trends, the Federation's structural net borrowing totalled approximately €53.9bn, or about 1.5% of GDP, according to preliminary macroeconomic data. This means that, according to preliminary data, the upper limit for structural net borrowing (0.35% of GDP in the year preceding the year when the budget was drawn up, in this case 2021 = approximately €12.6bn) was exceeded by about €41.3bn. The amount of €41.3bn by which the upper limit was exceeded is comprised of (a) €41.5bn in net borrowing for the Economic Stabilisation Fund (Energy), adjusted by the roughly -€0.029bn in financial transactions made by the fund and (b) a federal budget underrun of roughly €0.2bn below the regular limit set by the 2023 supplementary budget. The underrun itself is made up of the difference between (a) actual structural net borrowing in the amount of €12.4 (federal budget net borrowing of €27.2bn, adjusted by a financial transaction balance of -€7.7bn and a cyclical component of -€7.1) and (b) the upper limit of €12.6bn (or 0.35% of GDP). The amount of the underrun is credited to the control account. Exceeding the upper limit in this way (as provided for in the supplementary budget) is compatible with the constitution, based on the Bundestag's decision of 7 December 2023 to invoke an exception pursuant to Article 115 (2) sentences 6 and 7 of the Basic Law due to the ongoing profound humanitarian, social and economic repercussions of Russia's illegal war of aggression against Ukraine.

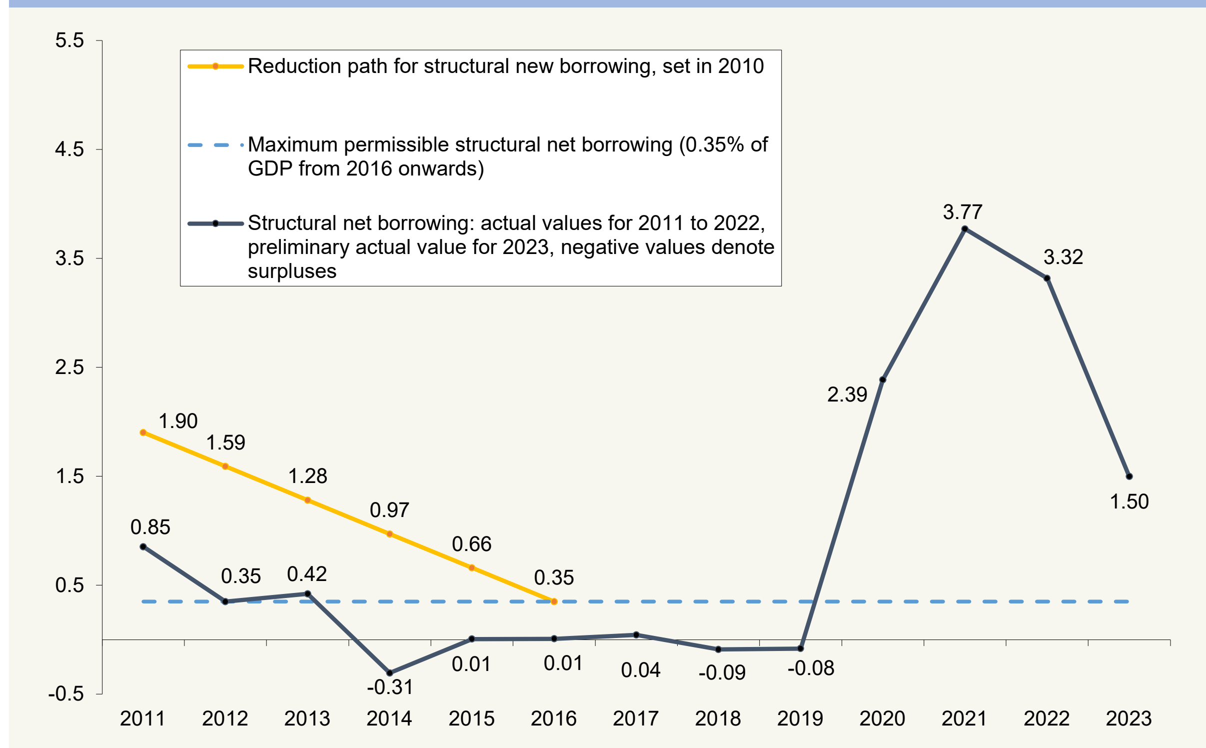
Pursuant to Article 115 (2) sentence 7 of the Basic Law, the German Bundestag must adopt amortisation plans for borrowing that exceeds the upper limit specified under the debt brake. The Bundestag has already done this for the years from 2020 to 2022. Repayment will take place from 2028 over a period of 31 years. When the criteria contained in the reasoning of the Federal Constitutional Court's judgment are applied, the judgment then also indirectly affects the Economic Stabilisation Fund (Energy), the special fund for reconstruction

aid following the 2021 floods, the special fund for digital infrastructure, and the special fund for all-day childcare. Specifically, this means that the reserves for these funds that are comprised of emergency borrowing authorisations can no longer be spent (taking into account funds that were already disbursed in previous emergency years). Both (a) the net borrowing amounts for the years from 2020 to 2022 that must be taken into account for purposes of the debt brake and (b) the amount by which the regular upper limit was exceeded are reduced by the amount of reserves that can no longer be spent. This in turn reduces the amortisation amounts. In addition, in accordance with a decision by the German Bundestag, the amount borrowed by the Economic Stabilisation Fund (Energy) in 2023 will be repaid over a period of 31 years starting in 2031 (taking into account the financial transactions already conducted), and the amounts borrowed to finance the expenditures made by the special fund for reconstruction aid will be repaid over a period of 31 years starting in 2028. Thus, according to current preliminary figures, approximately €9.2bn must be repaid annually in the years from 2028 to 2030. The repayment obligation for the Economic Stabilisation Fund (Energy) – approximately €1.7bn per year – will be added from 2031 onwards. According to preliminary figures, the repayment amount will total about €10.8bn per year from 2031 to 2058 and about €1.7bn per year from 2059 to 2061.

The 2024 federal budget, together with the fiscal plan to 2027 adopted by the federal government in July 2023, provide for a return to compliance with the regular borrowing limit under the debt brake from 2024 onwards. This is in line with Germany's fiscal policy strategy. Extensive adjustments will have to be made to the fiscal plan to 2027; this will be done during the budget preparation process. In late 2023 and early 2024, the federal government agreed on consolidation measures for 2024 that are guided by the overarching fiscal policy principle of setting spending priorities and improving the efficiency of public spending. In the core budget, the need for consolidation is reflected in a number of adjustments on

The Federation's structural net borrowing (in % of GDP)

Figure 4



Source: Federal Ministry of Finance

both the revenue and expenditure side. Key measures here include: increasing the tax rates in the Aviation Tax Act (*Luftverkehrsteuergesetz*); broader use of the proceeds from offshore energy tenders under the Offshore Wind Act (*Windenergie-auf-See-Gesetz*); a gradual discontinuation of diesel subsidies for agricultural and forestry businesses; adjustments to the citizen's benefit (*Bürgergeld*); spending reductions for individual ministries compared with the November 2023 version of proposed budget revisions; an expansion of the "job turbo" plan of action to accelerate the integration of refugees into the labour market; and updated macroeconomic assumptions. Thus the 2024 federal budget launched a process of qualitative consolidation that, in tandem with measures to boost incentives for work and private investment, will make structural improvements to promote economic growth and strengthen Germany's attractiveness as a place to do business.

Total target expenditure in the 2024 federal budget ended up being higher than the target in the government's draft budget due to (a) special factors such as the granting of an interest-bearing loan for the purpose of creating a capital stock to stabilise contribution rates in the statutory pension system (referred to as the "generational capital fund" or *Generationenkapital*) and (b) an increase in the equity of Deutsche Bahn AG. The expenditure-side adjustments to the Climate and Transformation Fund's 2024 economic plan reflect the need to set clearer priorities in terms of funding programmes following the Federal Constitutional Court's judgment. On the Climate and Transformation Fund's revenue side, the decision was taken to switch back in 2024 and 2025 to the previous government's original carbon price path for petrol, heating oil and natural gas (in line with the Fuel Emission Trading Act [*Brennstoffemissionshandelsgesetz*]). The original plan to raise the carbon price as of 1 January 2023 had been postponed for one year due to the sharp increase in energy prices at the time. The Climate and Transformation Fund's 2024 economic plan sets out expenditures totalling approximately €49.1bn, including about €29.9bn in investment spending.

The Federation's net borrowing of up to roughly €39.0bn provided for in the 2024 Budget Act (*Haushaltsgesetz 2024*), adjusted for financial transactions of about -€16.9bn and the cyclical component at the time of budget preparation of about -€7.7bn, results in structural net borrowing of approximately €14.4bn or 0.35% of GDP. This means that, in the budget preparation for 2024, Germany plans to regain compliance with the regular upper limit on structural net borrowing for the first time after four years of unusual emergency situations. This decision is in conformity with the far-sighted, prudent fiscal policy being pursued by the federal government, with the aim of reinforcing the sustainability of public finances through incremental budget consolidation. It is also in line with the European Commission's fiscal policy guidance, the Council's country-specific recommendations, and the EU's Sustainable Growth Strategy for 2024.

Following the stabilisation of overlapping crises and the provision of relief in recent years, the main energy price-related support measures for households and businesses (i.e. the price brakes for gas, electricity and heating) expired at the end of 2023. The drop in energy prices for end customers over the course of 2023 to below the reference level for the energy price brakes, and the decision to discontinue the price brakes (and, as a result, to dissolve the Economic Stabilisation Fund (Energy)), were used by the federal government to reduce the projected public deficit, in line with the country-specific recommendations. The reduction of discretionary fiscal support from 2023 to 2024 is another sign of the normalisation of fiscal policy. Germany's fiscal stance remains moderately restrictive following the budget adjustments that were carried out in December 2023 and January 2024.

The underlying strategic direction of Germany's fiscal policy for 2024 and subsequent years was set out in detail in the 2023 Update of the German Stability Programme. According to this, following several years of exceptional fiscal circumstances, Germany's fiscal policy is driven by two overriding strategic goals that

were also formulated by the EU as recommendations for fiscal policy and sustainable growth: (a) an efficient and forward-looking policy of fiscal resilience that focuses on the sustainability of public finances and (b) comprehensive and targeted supply-side policies to strengthen Germany's medium-term growth potential, especially with a view to the transformation towards a climate-neutral economy as well as digitalisation and demographic change.

Based on these strategic principles, Germany's medium-term fiscal policy focus is on continuously setting spending priorities and enhancing the effectiveness of public spending in order to achieve a qualitative consolidation of the federal budget that complements its quantitative consolidation. By reducing the expenditure path to the pre-crisis level from 2025 onwards and by continuing to comply with the regular borrowing limit under the national debt brake in subsequent years, as envisaged in the current fiscal plan to 2027, the federal government will make an important and necessary contribution to maintaining Germany's fiscal capacity in the face of rising spending requirements caused by demographic change, the need to respond to new geopolitical realities, and higher costs of public debt. In this way, the federal government is helping to stop federal budget expenditure from becoming locked in. The regular borrowing limit under the debt brake is a key component of German fiscal policy. It makes it possible to build up risk buffers for future crises, strengthens credible compliance with intertemporal government budget constraints and ensures the reduction of the debt-to-GDP ratio, thus maintaining the sustainability of German public finances. The debt brake is an expression of fiscal resilience – the negotiation processes involved create transparency regarding the conflicting objectives and costs associated with rising expenditures in areas that are crucial for Germany's future. The debt brake also bolsters the confidence of financial markets in the German state's creditworthiness and serves as insurance against unfavourable developments.

In view of the structural challenges facing the German economy – such as the transformation towards a climate-neutral economy, demographic change, low productivity growth (partly related to the fact that the existing potential in the area of digitalisation has not yet been tapped sufficiently) and geopolitical risks – the federal government is prioritising investments in the modernisation of the German economy. In the 2024 federal budget and the fiscal plan to 2027 that was adopted in July 2023, the federal government is maintaining its high level of investment spending in order to mobilise private investment, especially in the areas of decarbonisation, digitalisation and establishing a resilient energy infrastructure. In line with the turnaround in security policy it has pursued in recent years, the federal government is also continuing to invest in Germany's capabilities for effective national and alliance defence. The Special Fund for the Bundeswehr, which was set up in 2022 with an allocation of up to €100bn, is especially important in this context.

The second strategic goal of German fiscal policy is to increase potential growth by unleashing the allocative and productive forces of the market in order to boost economic momentum. In the current macroeconomic environment, which is characterised by real scarcities, greater economic growth can only be achieved by boosting aggregate supply and, above all, productivity. To achieve this goal, the federal government is pursuing a comprehensive and targeted supply-side policy that also supports the economy's transformation. The core elements of the supply-side policy are set out in detail in the 2024 Annual Economic Report. In particular, a successful supply-side policy requires the fiscal mobilisation of private investment. Given the scale of the mobilisation needed, as well as providing funding to activate private investment, it is important above all to establish attractive conditions for companies, provide a modern public infrastructure, take targeted steps to reduce uncertainty and strengthen Germany's position as an attractive place to do business. The federal government has therefore set itself the goal of creating an innovation-friendly environment with a competitive tax system, modernised

public administration and faster procedures. The federal government is undertaking ambitious structural reforms in these areas that will improve the conditions for start-ups, investment and innovation. It is providing a wide range of supply-side stimuli and has already implemented initial key measures of a comprehensive and targeted supply-side policy. With the Financing for the Future Act, it is strengthening the availability of private capital for investment and, in particular, making it easier for young companies and start-ups to access venture capital. The Growth Opportunities Act improves conditions for investment and innovation by creating targeted tax incentives, including more favourable loss deduction rules and an expansion of the tax allowance for research, as well as enhancing business liquidity, simplifying the tax system and easing the bureaucratic burden on companies. To boost economic momentum, the federal government will introduce numerous measures that will further cut red tape. This includes efforts to reduce existing bureaucracy, avoid new bureaucracy and make the public administration more agile and digital. As an important step towards improving conditions for businesses, the federal government is working towards reducing the duration of planning and approval procedures in Germany and increasing the availability of well-trained workers through initial and continuing education and training. The latter goal is supported by the Initial and Continuing Education and Training Act (*Aus- und Weiterbildungsgesetz*). The federal government has also adopted the Act on the Further Development of Skilled Immigration (*Gesetz zur Weiterentwicklung der Fachkräfteeinwanderung*) as well as a corresponding ordinance. These provisions significantly simplify skilled labour immigration from non-EU countries. With these measures, the federal government is enhancing the German economy's competitiveness, boosting productivity growth and thus creating the right conditions for strong and sustained economic growth by continuously strengthening the factors of production.

In its fiscal policy, the federal government also takes into account the strategic dimension of the international challenges facing an open and export-oriented economy. Germany's fiscal policy will promote resilient structures for global value creation in order to enable the country to adapt rapidly and bounce back strongly from crises. Fiscal policy can make it possible to harness positive externalities as part of a forward-looking approach, for example by funding research and development, and provide positive support for the diversification of the German economy's supply chains. The federal government will make targeted investments to improve the data infrastructure. This will help unlock the potential of research and development, especially in key enabling technologies such as artificial intelligence, quantum technologies and robotics.

3.3 Fiscal policy measures in terms of expenditure and revenue

Stabilisation and relief in the energy crisis

Despite declining wholesale energy prices, households and businesses continued to be burdened in 2023 by the extraordinary situation on German and European energy markets resulting from Russia's illegal invasion of Ukraine. This is because there is generally a time lag between price trends on spot and futures markets and their effects on final consumers. Consequently, the financial burdens caused by rising wholesale energy prices in 2022 still had an impact on households and businesses in 2023. The temporary, targeted relief measures that the federal government deployed in 2022 in response to the crisis, in keeping with the strategic focus of Germany's fiscal policy, continued to safeguard social cohesion, reduce uncertainty and protect the German economy's productive capacity in 2023. In 2022, the federal government adopted three major relief packages for 2022 and 2023 to manage the repercussions of Russia's invasion of Ukraine and related price increases. The total volume of the three packages was approximately €100bn. In addition, the federal government provided a "protective shield" for the economy in the form of the Economic Stabilisation Fund (Energy), which was equipped with up to €200bn in funding for loans to cushion the impact of the energy crisis.

The third relief package was adopted in September 2022 and provided more than €60bn in temporary assistance for pensioners, retired federal civil servants, university and vocational school students, and housing benefit recipients in 2022 and 2023. Because they were especially hard-hit by high energy costs, energy-intensive businesses were eligible for targeted, temporary and front-loaded assistance through the Energy Cost Mitigation Programme, with the aim of preventing structural disruptions to the economy and avoiding lasting damage to competitiveness. These short-term measures were accompanied by a wide range of structural changes to the energy market, an increase in the midi-job income limit to €2,000, and fundamental reforms to social benefit schemes.

Furthermore, significant relief was provided by multiple tax measures, including the updated income tax schedule set out in the Inflation Compensation Act (*Inflationsausgleichsgesetz*), which benefits roughly 48 million taxpayers. In 2023, relief from the Inflation Compensation Act totalled approximately €19bn. In 2024, this relief will increase by roughly €13bn to a total of €32bn. In this way, the federal government has prevented the income tax burden from rising while real income remains unchanged. The third relief package contained additional tax measures that will continue to provide tangible relief for households and businesses in the coming years. For example, the VAT rate on supplies of gas from the natural gas network has been reduced from 19% to 7% for the period from 1 October 2022 to 31 March 2024, the tax allowance for working from home has been made permanent, and pension contributions are now fully deductible from income tax.

The federal government's decisive reaction to avert impending economic disruptions caused by the increasing decline in supplies of Russian pipeline gas in 2022 and 2023 and reduce strategic vulnerabilities also continues to have a stabilising effect on economic activity. For example, in order to safeguard the supply of energy, stabilise the markets and maintain German and European economic competitiveness, the federal government supported gas importers and utility companies by providing liquidity support and loans. Additionally, filling gas storage facilities in line with clear government targets played a major role in maintaining supply security in Germany and throughout Europe.

The "protective shield" for the economy encompassed measures to stabilise the energy supply, various hardship provisions for vulnerable populations and certain hard-hit businesses, a moratorium on red tape and, in particular, price brakes for gas, heating and electricity that provided essential relief for households, small and medium-sized businesses and industrial firms. These measures curbed consumer price inflation, thereby helping to prevent second-round effects from rising energy prices. The energy price brakes were introduced in autumn 2022 and expired on 31 December 2023. The federal government's decision to let the price brakes expire was based on conditions on energy markets and trends in current end user prices for electricity and gas, which by the end of 2023 had generally fallen below the reference price levels for the energy price brakes.

Energy supply

Russia's illegal invasion of Ukraine confronted Germany and Europe with major challenges in the area of energy policy. In 2023, the federal government was successful in its efforts to guarantee supply security, diversify energy sources, cushion the social and economic impact of rising energy prices and promote the energy transition. The energy price brakes on electricity, gas and heating provided relief to numerous households and businesses in 2023. Thanks to the gradual decline in wholesale energy prices, the federal government was able to discontinue them at the end of 2023. The sustained downwards trend in gas and electricity prices in particular translates into falling retail prices and demonstrates that the federal government's efforts to increase the energy supply have been successful.

The federal government is taking decisive action to expand renewable energy: the amendment to the Renewable Energy

Sources Act (*Erneuerbare-Energien-Gesetz*), the Onshore Wind Act (*Wind-an-Land-Gesetz*) and the Offshore Wind Act (*Wind-auf-See-Gesetz*) contain measures to accelerate planning and approval procedures and raise the funding rates and tendering volumes under the 2023 Renewable Energy Sources Act. The federal government is also taking steps to expand the electricity grid in accordance with the grid development plan 2037/2045, which was adopted in 2023. The efforts to increase the electricity supply have been accompanied by a reduction of state-induced electricity price components: the electricity price package has temporarily reduced electricity duty for manufacturing companies as well as agriculture and forestry businesses to €0.5 per MWh, the lowest rate permitted by the European Union. This has made the relief scheme for electricity duty and energy duty (*Spitzenausgleich*) obsolete. Electricity price compensation, including the "super cap", has been extended and expanded, and the own contribution as well as the threshold amount have been eliminated. In this way, the federal government's electricity price package is improving conditions for and enhancing the competitiveness of the manufacturing industry, in line with Germany's strategic fiscal policy focus.

The federal government has agreed on key elements of a power plant strategy, which encompasses a raft of measures designed to maintain Germany's high level of electricity supply security. The legal implementation of the strategy will take place in 2024, subject to approval under state aid rules. The aim is to create a market-based and technology-neutral capacity mechanism that will become operational in 2028, replacing existing capacity-based remuneration systems. The mechanism will include up to four 2.5 GW H2-ready gas-fired power plants, which will be tendered imminently. The plants will switch their operations to hydrogen between 2035 and 2040. The regional distribution of these plants will be managed in such a way as to maximise benefits to the system as a whole. The roadmap for the switch to hydrogen will be announced in 2032. Hydrogen of all colours will be used. The federal government will provide suitable funding instruments to promote the development of new technologies (such as nuclear fusion) and the operational testing of new types of power plants. Plants that run entirely on hydrogen with a capacity of up to 500 MW will be financed from energy research funding. The issue of carbon capture, storage and utilisation (CCS/CCU) in gas-based electricity generation facilities is being explored under the Carbon Management Strategy. The federal government wants to take advantage of the potential of CCS/CCU to help reduce costs in the production of blue hydrogen. In addition, the federal government aims to enable the use of CCS/CCU in gas-based electricity generation facilities as well as the use of biomass (BECCS).

Furthermore, as part of the power plant strategy, it has been agreed that existing obstacles to the establishment and operation of electrolysers will be fully removed and all options to accelerate the expansion of electrolysers, particularly those that can be run in a way that is beneficial to the system, will be explored. The federal government will also ensure that there are no double charges or fees on the electricity used for storage and electrolysis, thus providing incentives for the production of hydrogen that are both market-based and beneficial to the system. All existing regulatory obstacles will be removed to the extent possible to allow for the unrestricted use of surplus electricity.

The federal government is also working on ramping up the hydrogen economy. To this end, the national hydrogen strategy was updated in 2023. Germany's hydrogen import strategy will be published this year. Its aim is to tap diversified import channels in order to ensure a resilient supply. The federal government's objective is to swiftly and cost-efficiently establish a hydrogen network infrastructure that grows along with the hydrogen market and is embedded in the EU single market. The first steps towards creating a planning and regulatory framework for such a hydrogen infrastructure were taken in the form of the amendment to the Energy Industry Act (*Energiewirtschaftsgesetz*), which was adopted by the federal cabinet on

24 May 2023. According to this, the hydrogen transport network in Germany will be developed in two stages: First, a core network will be built to connect central hydrogen production and consumption centres across Germany (such as large industrial centres, storage facilities, power plants and import corridors). Then, the hydrogen network will be further developed in a needs-based way as part of integrated grid development planning for gas and hydrogen. The legal prerequisites for integrated grid development planning and for financing the core network will be laid down in the Third Act Amending the Energy Industry Act (*Drittes Gesetz zur Änderung des Energiewirtschaftsgesetzes*), for which the parliamentary procedure will be completed in the second quarter of 2024. Subsequently, the transmission system operators will submit an application for the core network to the Federal Network Agency (*Bundesnetzagentur*). As with natural gas and electricity, hydrogen transport pipelines will, in principle, be financed entirely by the private sector through user charges. However, because the number of customers will initially be low, the high initial investment costs cannot be passed on to users in full. Grid charges will therefore be capped in order to prevent the very high charges in the first few years of grid development from hampering the ramp-up of hydrogen. The aim is to create an amortisation account as a mechanism for balancing out costs over the long term, with initial shortfalls compensated by later surpluses (when the number of users is high). The federal government plans to adopt the Hydrogen Acceleration Act (*Wasserstoffbeschleunigungsgesetz*) before the end of 2024.

In 2023, in order to avert the risk of energy supply emergencies, the federal government strengthened its crisis preparedness and bolstered its capacity to handle emergency shortages by amending the Energy Security Act (*Energiesicherungsgesetz*) and other ordinances governing energy industry activities. The Gas Storage Act (*Gasspeichergesetz*), which forms part of the Energy Industry Act and is based in part on EU regulations, stipulates that gas stores must be well filled at the beginning of the heating period to reduce the risk of gas shortages during the winter (85% as of 1 October, 95% as of 1 November and 40% as of 1 February). It has been extended by two years, to March 2027. In autumn 2023 and winter 2023/2024, the stipulated storage levels were once again met or significantly exceeded before the respective deadlines. To gradually return to a market-based system of filling gas stores, the remaining government gas reserves are being sold in a market-friendly manner in the winter of 2023/2024. The process of transitioning the gas import infrastructure from pipeline-based gas imports from Russia to liquefied natural gas (LNG) began in winter 2022/2023 with the commissioning of two government-chartered floating storage and regasification units (FSRUs) in Wilhelmshaven and Brunsbüttel as well as one private FSRU in Lubmin. This process will contribute to diversifying the gas supply and reducing dependence on individual exporting countries such as Russia. Over the course of 2024, three further FSRUs will commence operation: two government FSRUs in Stade and Wilhelmshaven and one private FSRU in Mukran on the Baltic Sea. This will support the expansion of aggregate supply and boost the growth potential of the German economy.

Climate action

The federal government is a global advocate for ambitious climate policies and is taking far-reaching measures to limit climate change. Germany and the European Union have set the ambitious target of achieving net carbon neutrality by 2045 (Germany) and 2050 (EU). The federal government adopted its 2023 Climate Action Programme in October 2023. The impact assessment of the programme's measures found that they will make a very significant contribution towards reducing greenhouse gas emissions. At the start of the current legislative period, the federal government faced a cumulative emissions gap of over 1,100 million tonnes of carbon equivalent for the period from 2022 to 2030 (based on the 2021 Projection Report and the 2021 initial assessment by the Federal Ministry for Economic Affairs and Climate Action). However, if the measures in the 2023 Climate Action Programme are implemented consistently, it was projected that this gap will be reduced by about 900 million tonnes.

The latest projections presented on 15 March 2024 by Federal Minister for Economic Affairs and Climate Action Robert Habeck and Federal Environment Agency President Dirk Messner show that the climate action gap can even be closed completely if the agreed measures are implemented consistently (overfulfilment of 47 million tonnes of CO_2 equivalents). In addition, the federal cabinet adopted an amendment to the Climate Action Act (*Klimaschutzgesetz*) in 2023. The amended act aims to make German climate action policy more far-sighted and effective. The draft legislation shifts the policy focus towards a forward-looking, multi-year and cross-sectoral approach to overall emissions accounting. Germany's ambitious climate targets remain unchanged, but the amended Climate Action Act now places a stronger emphasis on achieving the objective of carbon neutrality rather than looking back at missed targets. The legislation's chief focus is now on measures that will be most effective and efficient over the long term rather than on fragmented, sector-specific initiatives that are often too short-term in nature.

A complete shift to climate-friendly production frequently entails high costs. To help make the transformation process as affordable and efficient as possible, the federal government is using carbon pricing as a lead instrument for climate policy. The instrument of carbon pricing creates decarbonisation incentives for decentralised business decisions, which means that emissions reductions are carried out where they bring the most cost benefits. This mechanism is in line with the strategic principles of an efficient fiscal policy that places a priority on decentralised solutions that take the form of price signals. One key instrument is the carbon pricing scheme that was agreed in 2019 as part of the Climate Action Programme 2030 and introduced in 2021 in the form of a national emissions trading system in the heating and transport sectors. These sectors are scheduled to be subject to pricing at the European level from 2027 onwards within the framework of the revised EU Emissions Trading System (ETS II). The ETS II was adopted as part of the EU's "Fit for 55" package. The Fit for 55 package also extends the existing ETS I system (for industry and energy) to include the maritime sector. As a result, in the future, nearly 85% of all carbon emissions in the EU will be subject to emissions trading. This further reinforces a crucial instrument for meeting climate targets efficiently. In order to prevent carbon leakage (the shifting of carbon emissions to countries outside the EU due to higher costs related to EU climate policies), the EU introduced the Carbon Border Adjustment Mechanism (CBAM) on 1 October 2023. During CBAM's current transitional phase, only reporting requirements apply. Then, when CBAM goes into full operation in 2026, a carbon price will be imposed on goods from certain sectors (steel and iron, aluminium, cement, fertilisers, hydrogen and electricity) that are imported into the EU and that are subject to little or no carbon pricing during the production process outside the EU internal market. Concomitant with the introduction of CBAM, the allocation of free allowances to carbon-intensive industries in the EU will be gradually phased out and is scheduled to be fully discontinued by 2034. Proceeds from Germany's national carbon pricing scheme are allocated to the Climate and Transformation Fund, and the same will apply to Germany's share of proceeds from the EU's emissions trading system. The Climate and Transformation Fund is an important financing instrument for the energy transition and climate action in Germany.

In the energy sector, Germany is taking measures to swiftly expand the role of renewables. The federal government aims to achieve the 80% renewables target enshrined in the 2023 Renewable Energy Sources Act by 2030. This will take place against the backdrop of sharply rising electricity demand due to the planned electrification of the supply of energy to buildings, transport and industry. Furthermore, the federal government is adopting and implementing additional complementary measures. For example, the federal cabinet adopted the first "solar package" on 16 August 2023. This is an important legislative package containing a wide range of measures to accelerate the build-up of solar power installations and to cut red tape (this includes expanding

the funding available for solar farms as well as a new strategy for the joint use of solar power in apartment buildings).

Targeted measures have also been taken in the buildings sector. For example, the second amendment of the Building Energy Act (*Gebäudeenergiegesetz*) and the Heat Planning Act (*Wärmeplanungsgesetz*) have been in force since 1 January 2024. The core element of the revised Building Energy Act stipulates that renewable energy must account for at least 65% of the power used in all newly installed heating systems. Initially, this will apply only in new development areas. Newly installed heating systems in existing buildings as well as new buildings outside new development areas (i.e. vacant lots) will not be subject to this requirement until the deadlines for municipal heat planning (which represents an advanced planning and investment instrument), as stipulated in the Heat Planning Act: starting no later than 1 July 2026 in cities with populations of 100,000 or more and starting on 1 July 2028 in all other districts. Fossil fuel-run heating systems that are installed after 1 January 2024 and prior to the application of the 65% renewables rule must partly use climate-friendly fuels starting in 2029. Existing heating systems are not affected by the new rules and may continue to be used and repaired. However, in line with Germany's carbon neutrality target, no fossil fuel-run heating systems may be operated after 1 January 2045 at the latest. The shift to renewable energy is being carried out in a technology-neutral and socially acceptable manner. For this reason, the Building Energy Act contains further transitional arrangements (for example, in cases where a prospective connection to a heating network exists) as well as a general hardship provision that permits exemptions upon request. The adjusted conditions under the funding programme "Federal funding for energy-efficient buildings" complement the provisions of the Building Energy Act, thereby helping individuals, businesses and local authorities to implement the new requirements.

Key climate policy measures taken in the transport sector include the introduction on 1 May 2023 of the *Deutschlandticket* (a local and regional public transport ticket that is valid throughout Germany) and the introduction in December 2023 of a carbon surcharge on Germany's HGV toll, alongside an initial HGV toll exemption for emissions-free commercial vehicles and, at a later stage, a reduced HGV toll for these vehicles as a contribution to infrastructure costs. To help achieve the ambitious climate targets for the industrial sector by 2030, the carbon pricing scheme is backed up by a wide range of targeted funding programmes that provide early-stage incentives to invest in the transformation and that encourage reinvestments in climate-neutral restructuring. The federal government is also continuing to build the foundations for "green lead markets" in line with European standards. The objective is to develop markets for goods that are produced in a climate-friendly manner and thus to reduce the need for government support. The Climate and Transformation Fund provides funding in particular for measures that promote energy-efficient building retrofits; the decarbonisation of industry; the development of a hydrogen economy; the expansion of electric mobility, charging infrastructure and renewable energy use; and improvements in energy efficiency.

Public investment

In keeping with the strategic focus of Germany's fiscal policy, the federal government is investing in areas that are crucial for Germany's future. The state is responsible for ensuring high-quality public infrastructure and administration. Furthermore, it is important to mobilise private investment by pursuing supply-side economic and fiscal policies.

The 2024 federal budget achieves a balance between social security, tax relief, consolidation of public finances and crucial investment in a modern, digital and carbon-neutral Germany. Public investment spending is at a very high level. With investments financed through the federal budget, the Federation

is making a significant contribution to the positive development of real gross capital formation at the general government level. For 2024, €53bn have been earmarked in the core budget to maintain the high level of investment spending. Investment spending in 2024 will total €70.5bn, taking special factors into account (under budget law, the €12bn loan to the "generational capital fund" and the €5.5bn in additional equity for Deutsche Bahn AG must be recorded as investments). Adjusted for these special factors and for inflation, investment is significantly above the pre-crisis level (€38.1bn in 2019). In addition to the investments in Germany's future that are contained in the federal budget, expenditures totalling approximately €49.1bn have been earmarked for the Climate and Transformation Fund, including about €29.9bn in investment spending.

General government gross fixed capital formation according to the definition laid down in the European System of Accounts is expected to grow by an average of 4½% per year from 2023 until 2028. The projected rate of growth for this period is thus above the expected average nominal potential growth rate of 2.7% per year.

Labour market

The federal government is pursuing an employment-friendly labour market policy that aims to increase the available labour supply, make use of existing potential by strengthening incentives to work, and boost labour productivity in order to enhance economic growth. This is especially important against the backdrop of increasing shortages of skilled labour. The federal government has taken a number of measures in the areas of initial and continuing education and training, employment incentives, labour force participation and employment-related immigration.

Following drops in purchasing power as a result of high inflation rates in 2022, real wages have increased slightly since the second half of 2023. As a result of higher negotiated wage agreements, gross wages and salaries per employee (effective wages) rose at a higher rate in 2023 than in the previous year. Another factor was the substantial minimum wage increase to €12 per hour in October 2022. On 1 January 2024, the minimum wage was further increased to €12.41 per hour as part of the regular review process, following the suggestion of the Minimum Wage Commission. By increasing the minimum income limit for mini-jobs to €538 alongside the increase in the minimum wage, the federal government is pursuing its objective of further increasing labour market participation. The minimum income limit for mini-jobs is linked to minimum wage trends and is therefore flexible.

On 1 January 2023, the "citizen's benefit" (*Bürgergeld*) replaced the previous unemployment benefit (*Arbeitslosengeld II*) and social benefit (*Sozialgeld*). With the introduction of the citizen's benefit, the federal government has modernised basic income support for jobseekers and improved cooperation between job centres and benefit recipients. The new system maintains a balance between supporting people in need and creating incentives to actively look for and take up work. The reform improves employment incentives – since 1 July 2023, young people's income (e.g. apprenticeship pay) is not taken into account as income up to the amount of the minimum income limit for mini-jobs, and the tax allowance for people earning between €520 and €1,000 per month has been increased from 20% to 30%. At the same time, the federal government wants to ensure that work pays off and help prevent benefit fraud. Under the Second 2024 Budget Financing Act (*Zweites Haushaltsfinanzierungsgesetz 2024*), the rules of the Citizen's Benefit Act (*Bürgergeld-Gesetz*) were adjusted to include the possibility of completely withdrawing standard benefit payments for up to two months if the recipient wilfully refuses to take up reasonable work without a reason. In the Citizen's Benefit Act, the federal government also modified the procedure for adjusting standard benefit rates in order to better reflect relevant current price trends during regular adjustments of these rates. As a result, benefit rates increased by approximately 12% from 1 January 2024 onwards. This adjustment procedure will be reviewed as part

of the calculation of standard benefit rates that will be carried out after the 2023 Income and Expenditure Survey is issued.

In order to increase the performance potential of the working-age population, the federal government has created targeted incentives for further education and training and is looking into how to raise awareness of, and further improve, opportunities for career changes and skills development. To that end, the federal government is continuing to develop and pursue the National Skills Strategy, together with the *Länder*, the Federal Employment Agency and social partners. The Initial and Continuing Education and Training Act has the aim of strengthening continuing education and training in order to prevent unemployment caused by structural change and maintain the supply of skilled labour. Among other things, the legislation simplifies funding for continuing education and training of employees and introduces a skills development benefit that will help companies ensure that their employees acquire the right skills in times of structural change. The "training guarantee" introduces a funded career orientation internship scheme and a mobility subsidy, facilitates participation in introductory training, and further opens up school-based vocational training. In addition, continuing education and training has been anchored more strongly in the citizen's benefit. Funding opportunities for continuing vocational education and training will be made more flexible and attractive in order to motivate unemployed people and low-skilled workers in particular to embark on and successfully complete continuing education and training.

Through other targeted measures to expand the labour supply and increase labour productivity, the federal government is creating good conditions for fast-growing companies and future prosperity by enhancing growth potential and ensuring strong economic growth. To this end, conditions for higher labour force participation and increased individual working hours need to be improved further. To respond to changes in working life, the federal government plans to help unions and employers create possibilities for flexible working time arrangements, allowing both employees and businesses to organise working times in a more flexible way.

The government seeks to explore the untapped potential to improve employment incentives for people in lower income brackets. The current system of transfer benefits is characterised by widely differing and, in some cases, very high marginal tax rates. The federal government will review possible reform options for benefit withdrawal rates on the basis of an academic expert report.

The ongoing immigration of skilled workers and their quick integration into the labour market also offers great potential to increase the labour supply. The federal government wants to further increase the immigration of skilled workers and their families and accelerate the integration of refugees into the labour market. It has created a modern, cross-sectoral framework for this in the form of the Skilled Labour Strategy and the Act on the Further Development of Skilled Immigration as well as a corresponding ordinance, which will enter into force in three stages up until 1 June 2024. Going forward, labour immigration from non-EU countries will be based on three pillars. The "skilled labour pillar" is open to skilled workers who hold a recognised qualification in any non-regulated occupational field. The "experience pillar" is new – it offers a pathway for immigration without prior formal recognition of qualifications in non-regulated professions. In addition, recognition partnerships give immigrants an opportunity to take up work in Germany while their recognition procedures are still pending. The third pillar is the "potential pillar" – it introduces an opportunity card (*Chancenkarte*) that will allow people to come to Germany to look for work based on a points system.

To meet the existing urgent demand for skilled workers, the federal government has made further changes to residence and nationality rules that will give refugees easier access to the labour market. Refugees from Ukraine have full access to the labour market and to all employment promotion measures under

Book II of the Social Code (*Sozialgesetzbuch II*) from the time they arrive in Germany. The federal government has also taken steps to improve the labour market integration of people permitted to remain pending an asylum decision and people whose deportation has been temporarily suspended. Last but not least, the federal government has launched the "job turbo" plan of action, which contains a range of measures designed to ensure the quick and sustainable integration of refugees into the labour market. Job centres will provide greater support to refugees who have completed integration courses in finding potential-based work experience in which they can develop their skills. Employers are called upon to create suitable opportunities and help refugees develop their language skills and qualifications.

Education and research

The federal government continues to give high priority to the future-oriented areas of education, science and research. The Federal Ministry of Education and Research (departmental budget 30) has a total of €21.5bn at its disposal in 2024, as it did last year.

The federal government has set itself the goal of helping individuals unlock their potential, achieving a turnaround in the skills development of pupils, and increasing equality of opportunity in education. The aim is to renew the promise of advancement in Germany. From the 2024/2025 academic year onwards, the "Startchancen" programme for a better educational start in life will provide targeted support over a period of ten years to about 4,000 general education and vocational schools that have a high proportion of socially disadvantaged pupils. Schools included in the programme will offer children and young people evidence-based learning support as well as wide-ranging opportunities to shape their individual education pathways and develop their personalities. In doing so, the schools will take into account pupils' individual starting situations. The Federation is investing approximately €10bn over the ten-year programme period. The *Länder* are matching this amount. In the Digital Pact for Schools, the Federation is helping the *Länder* and local authorities invest in digital learning infrastructure. The aim is to build up a nationwide modern digital learning infrastructure that is guided by educational expertise. The Digital Pack for Schools has a total volume of €6.5bn, of which €1.25bn is available to the Federal Ministry of Education and Research in 2024 under departmental budget 30.

The draft of the 29th Act Amending the Federal Training Assistance Act (*29. BAföG-Änderungsgesetz*) sets out further improvements to the Federal Training Assistance Act (*Bundesausbildungsförderungsgesetz*) and the Upgrading Training Assistance Act (*Gesetz zur Förderung der beruflichen Aufstiegsfortbildung*). Changes include an increase in allowances for parents' and spouses' income of 5% as well as for own income in line with the mini-job limit applicable from 1 January 2025, the provision of €1,000 in starting assistance for young university students from underprivileged families, and the introduction of a flexibility semester.

On 27 November 2023, the Federation and the *Länder* decided to further develop and continue the programme for research at universities of applied sciences that has been running since 2003. The aim is to ensure that universities of applied sciences can continue to develop their application-oriented research potential. The Federation and *Länder* will jointly provide a total of nearly €0.5bn in project funding from 2024–2030.

Providing financial support to universities remains a key priority for the federal government. On the basis of an agreement to strengthen teaching and learning in higher education, the Federation and the *Länder* have been making improvements in the quality of teaching and learning at higher education institutions and maintaining capacities in Germany as required. Like the Pact for Research and Innovation, this programme was given fresh momentum starting in 2023. Approximately €2.1bn have been earmarked for this purpose in the 2024 federal budget. The Federation will make a total of approximately €7.8bn in grants available to leading

research centres participating in the Pact for Research and Innovation IV (German Research Foundation, Fraunhofer Society, Helmholtz Association, Leibniz Association and Max Planck Society) in 2024 under departmental budget 30, enabling them to conduct high-quality basic and applied research. The annual institutional grants will increase by 3% year-on-year, in line with the target set out in the Pact for Research and Innovation.

To fund research through national, European and international project grants in 2024, departmental budget 30 will have a total of approximately €1.3bn for innovation based on new technologies, approximately €0.6bn for innovation in the life sciences, approximately €0.9bn for research in the field of sustainability, climate and energy, and approximately €0.5bn for selected priority areas in basic physics research.

The federal government wants to ensure that Germany and Europe play a leading role in key areas of research and innovation policy that are crucial for the future. In order to not only maintain Germany's innovative capacity, but continuously enhance it, it is necessary to broaden the innovation base and optimise structural conditions. The aim is to ensure that as many stakeholders as possible from business and society can actively participate in innovation. The federal government's measures are also designed to increase gender equality and diversity in general so as to ensure that the brightest minds are attracted to research and innovation, regardless of their social background. The government is also funding SMEs, which are technological pioneers in many areas but face special challenges when it comes to research and innovation financing. Measures to address this include the "SME innovative" initiative, cluster and network funding and a wide range of specialist programmes.

Housing

Affordable housing is a major factor affecting the quality of life of people in Germany. The housing sector also plays a key role in the transformation towards carbon neutrality.

However, the economic conditions for investment in the construction and renovation of housing have changed considerably over the last three years. Investment in construction services has slowed down, particularly as a result of higher building material costs (on the supply side) and inflation-related drops in purchasing power as well as higher financing costs (on the demand side). Improving economic and fiscal policy conditions can thus create incentives for investing in Germany's building stock.

Against this background, the federal government has taken targeted measures that make efficient use of budget resources to facilitate investment in construction and thus support the recovery of the construction sector as a whole. Under the "climate-friendly new construction" programme, the federal government has been supporting climate-friendly and energy-efficient residential and non-residential buildings since March 2023 in the form of reduced-interest loans and grants (the latter are provided only to local authorities). A new "climate-friendly new construction in the low-cost segment" programme will be launched, with budget funds of €1bn. The corresponding funding plan is currently being developed. In addition, the federal government launched the "home ownership for families" funding programme in June 2023. Under this scheme, households with at least one minor child and taxable annual income of up to €90,000 can receive support in order to buy or build an energy-efficient owner-occupied home. Programme funds of up to €350m from the Climate and Transformation fund are available for this purpose for new grants approved in 2024.

Under the current fiscal plan, the Federation will make a total of €18.15bn available to the *Länder* for social housing over the 2022–2027 period. The programme funds are co-financed by the *Länder*, meaning that the total sum available for social and affordable housing is expected to be more than twice this amount.

Families and social affairs

Efficient social policies that offer the right incentives can safeguard people's basic needs and enhance their opportunities to participate in society and employment. The federal government is providing significant support to families. The tax allowance for children (*Kinderfreibetrag*) was increased for 2023 and 2024 in accordance with constitutional necessity. At the same time, monthly child benefit payments were increased to a uniform €250 per child as of 1 January 2023, a proportionately bigger rise than the increase in the tax allowance for children. This significant single relief measure was taken partly in anticipation of the planned introduction of a basic child allowance (*Kindergrundsicherung*). Low-income families will continue to receive assistance in the form of the child supplement, which was increased by €42 to €292 per month per child as of 1 January 2024, including the immediate supplement. The federal government's planned introduction of the basic child allowance will bundle different child benefits into one allowance, and will focus, among other things, on simplifying and digitalising processes.

The government has taken numerous measures, such as parental allowance, to improve the balance between family and work life, increase working hours and labour force participation among women, and promote greater equality of opportunity. The federal government is providing the *Länder* with a total of €5.4bn for the quantitative expansion of child daycare services, which can be drawn down until mid-2024. The *Länder* also receive €845m a year as part of the vertical distribution of VAT to help childcare facilities cover additional operating costs arising from these additional childcare places. To help offset the additional burdens placed on the *Länder* to promote quality and inclusion in child daycare, the Child Daycare Quality Act (*KiTa-Qualitätsgesetz*) is providing the *Länder* with approximately €4bn in additional funding in 2023 and 2024 through vertical VAT distribution.

Under the All-day Childcare Act (*Ganztagsförderungsgesetz*) of 2021, a legal entitlement to all-day care for primary school children will be gradually introduced from 1 August 2026. To implement this legal entitlement, the Federation is providing the *Länder* with €3.5bn in financial assistance under the All-Day Childcare Financial Assistance Act (*Ganztagsfinanzhilfegesetz*) to expand childcare infrastructure. The funding can be drawn down until 31 December 2027. To take account of the ongoing additional burden on the *Länder* resulting from this legal entitlement, a change in the vertical distribution of VAT in favour of the *Länder* has also been introduced, with a gradual increase from €135m in 2026 to €1.3bn a year from 2030 onwards.

Health

Although the additional expenditures and revenue shortfalls in the healthcare system have declined with the end of the Covid pandemic, the federal government continues to face the challenge of closing the gap between macroeconomic growth and public healthcare costs, which are rising at a faster pace due to demographic change and technological progress in the medical field. New additional burdens have resulted from high inflation rates due to the economic impact of Russia's war of aggression against Ukraine as well as supply chain bottlenecks for medications. To help mitigate the impact of high energy costs resulting from the energy crisis, the federal government provided supplementary funding from the Economic Stabilisation Fund (Energy) amounting to €8bn for hospitals and care homes up to the end of 2023 on the basis of special hardship provisions. Thanks to targeted measures under the Statutory Health Insurance Financial Stabilisation Act (*GKV-Finanzstabilisierungsgesetz*), the financial situation of the statutory health insurance funds was stabilised in 2023 and 2024 and additional burdens on contributors were kept to a moderate level, despite the challenges set out above.

The Federation has provided €3bn in funding since 2021 under the Hospital Future Fund to help hospitals invest in better IT security

and digital infrastructure, with the *Länder* and/or hospital operators contributing up to €1.3bn in additional co-funding. Unclaimed investment funding will be returned to the Federation by the end of 2025.

In accordance with section 221 (1) of Book V of the Social Code (*Sozialgesetzbuch V*), the Federation provides €14.5bn per year to the statutory health insurance system as a flat-rate payment to cover health insurance funds' expenditure on non-insurance related benefits. The federal government is committed to ensuring stable and reliable financing of statutory health insurance over the coming years. To this end, it intends to continue on the current path of leveraging efficiency potential within the system in order to maintain its future ability to finance health services in a sustainable way while also ensuring high quality standards in healthcare as required. For example, with the Act to Accelerate the Digitalisation of Healthcare (*Gesetz zur Beschleunigung der Digitalisierung des Gesundheitswesens*) and the Act on the Use of Health Data (*Gesundheitsdatennutzungsgesetz*), the federal government launched a range of measures in 2023 to reduce unnecessary bureaucracy in the healthcare system and take better advantage of the potential that digitalisation has to offer.

It is also important to put in place measures and solutions for improving financial structures in the long-term care insurance system in order to ensure its long-term sustainability. The Federal Ministry of Health will issue recommendations for the stable and permanent financing of long-term care insurance by the end of May 2024, with a particular emphasis on the expenditure side of the long-term care insurance system.

Security, defence and international responsibility

To meet the multifaceted challenges that Germany faces in the area of security policy, the federal government adopted the first German National Security Strategy in June 2023. The strategy's guiding principle of integrated security, in which all relevant stakeholders, funds and instruments work together to maintain Germany's security in a comprehensive way, is also reflected in Germany's fiscal policy.

Russia's ongoing illegal war of aggression against Ukraine and the heightened level of threat Europe is facing underline the urgent need to invest in Germany's capabilities for effective national and alliance defence and to significantly enhance these capabilities in close coordination with allies and partners who share Germany's values. Together with all NATO allies, Germany made a commitment at the 2023 NATO summit in Vilnius to spend at least 2% of GDP on defence every year on a permanent basis. This is in keeping with the 2% target set out in the federal government's National Security Strategy. Germany is implementing this objective in the 2024 budget and the 2024 economic plan for the Special Fund for the Bundeswehr, and will continue to spend at least 2% of GDP on defence in the coming years. In 2024, the federal government will spend €7.1bn on providing military support to Ukraine. Germany is the second-largest bilateral donor after the US, both in terms of overall aid and in terms of military support.

The federal government is committed to strengthening economic security and resilience at the national, European and international level in order to meet the increasing geo-economic challenges. In this context, it is important to take advantage of open and dynamic economic and trade relations in order to strengthen the economic resilience of Germany and the EU. A key element of the federal government's approach is to strengthen international partnerships in order to create the right conditions and incentives for reducing critical dependencies in economic and fiscal relations.

The federal government is pursuing a strategy of openness and simultaneous de-risking, for example through diversification as part of an ambitious trade agenda, adjustments to Germany's foreign trade instruments and a stronger focus on the markets of the future. At the same time, it is working towards securing critical raw materials and intermediate products for manufacturing, for example by

concluding raw material partnerships and by enhancing resource efficiency, the circular economy and recycling. It is also crucial for Germany and the EU to have their own production capacities in certain key technology areas, such as the arms industry. This includes further developing existing security instruments such as investment reviews and developing targeted new instruments designed to reduce supply security risks and prevent critical technology transfer.

For the federal government, the correct way to deal with risks to economic security and resilience is not to increase protectionism, which leads to fragmentation and puts prosperity at risk. Instead, the federal government is committed to the open global economic order and to rules-based multilateralism while remaining aware of the need to exercise due vigilance. The federal government is therefore working together with partner countries around the world to overcome global challenges and protect global public goods within the framework of multilateral organisations and forums, including development banks, the International Monetary Fund, the World Trade Organization, the sub-organisations of the United Nations and forums such as the G7 and G20.

Strengthening global partnerships is a key component of these efforts. In the area of development cooperation, Germany has for years been the second-biggest donor (after the US) by some margin in absolute figures as well as the biggest donor in the G7 in relation to GNI (taking into account the spending of the Federation, *Länder* and local authorities that is eligible as Official Development Assistance [ODA], including relevant EU spending). The 2024 budget contains ODA spending totalling €21bn, of which the Federal Ministry for Economic Cooperation and Development will provide the largest share (approximately €11.2bn), followed by the Federal Foreign Office (approximately €3.9bn).

Taxes and duties

The federal government's objective is to strengthen the German economy's competitiveness and productivity in order to maintain and renew prosperity in a globalised world. A pro-growth, pro-innovation tax framework in line with the strategic focus of Germany's fiscal policy helps to facilitate the continuous expansion of aggregate supply, strengthen fiscal capacity and safeguard sustainable public finances. Tax policy can make a significant contribution towards achieving these objectives while simultaneously supporting the transformation towards a digital, net-zero economy.

Following the relief measures that were taken during the crises of recent years, the federal government is now shifting back towards fiscal and tax policy normality and taking measures to ensure confidence in sustainable economic growth and public finances. This shift is reflected in the expiration of certain crisis-related measures, meaning that specific support for individual sectors that were especially hard-hit by the Covid-19 pandemic and/or by Russia's war of aggression against Ukraine is declining. This includes, in particular, the expiration of the reduced VAT rate in the catering sector as of 31 December 2023 and the expiration of the reduced VAT rate on gas and heating as of 31 March 2024.

The federal government's objective is to create a tax environment for businesses that strengthens investment capacity, improves incentives to invest and innovate, and cuts red tape. This is crucial for productivity growth and economic success.

The Growth Opportunities Act improves conditions for investment and innovation across all sectors and simplifies the tax system. The agreed measures are designed to improve business liquidity, create space for more investment and innovation and thus strengthen the German economy's competitiveness. Overall, the Growth Opportunities Act provides relief totalling approximately €3.2bn per year. The tax incentives for private investment and innovation include more favourable loss

deduction rules, the temporary reintroduction of accelerated depreciation options for movable assets, the introduction of accelerated depreciation for newly constructed residential buildings, and improved special depreciation arrangements for small businesses and new rental housing. To support innovation in a targeted way, the federal government will also expand tax incentives for R&D in the form of the tax allowance for research, which will be made more attractive by extending the funding to certain material costs, increasing the assessment basis to €10m and raising the funding rate for SMEs from 25% to 35% upon request. In addition, the federal government is taking steps to simplify key aspects of the tax system and cut red tape for small businesses in particular by raising fiscal and commercial thresholds and standard rates.

The Financing for the Future Act (*Zukunftsfinanzierungsgesetz*) provides for better financing conditions, improves tax frameworks and modifies company law in ways that will enhance Germany's attractiveness as an investment destination for innovative entrepreneurs and start-ups. In the areas of financial market and company law legislation, this includes reduced minimum capital requirements, the option to introduce multiple-vote shares and rules to facilitate capital increases. Measures to promote further digitalisation and internationalisation and to further reduce red tape will make the German financial market more attractive and strengthen Germany's position as a magnet for business – for both domestic and international companies and investors. The legislation also contains key tax provisions that aim to promote employee share ownership, including significantly expanded deferred taxation on employee shares for start-ups and scale-ups as well as an increase in the annual tax allowance for employee shares from €1,440 to €2,000. Among other things, these measures are designed to improve conditions to help start-ups and scale-ups recruit and retain talent and skilled staff. In addition, the government is doubling the income thresholds for employee savings schemes to €40,000 for individual filers and €80,000 for joint filers. This includes the investment of capital-forming benefits in shares (including investment funds) and their use to finance housing-related costs (including through home-ownership-related saving schemes), both of which create investment incentives for employees.

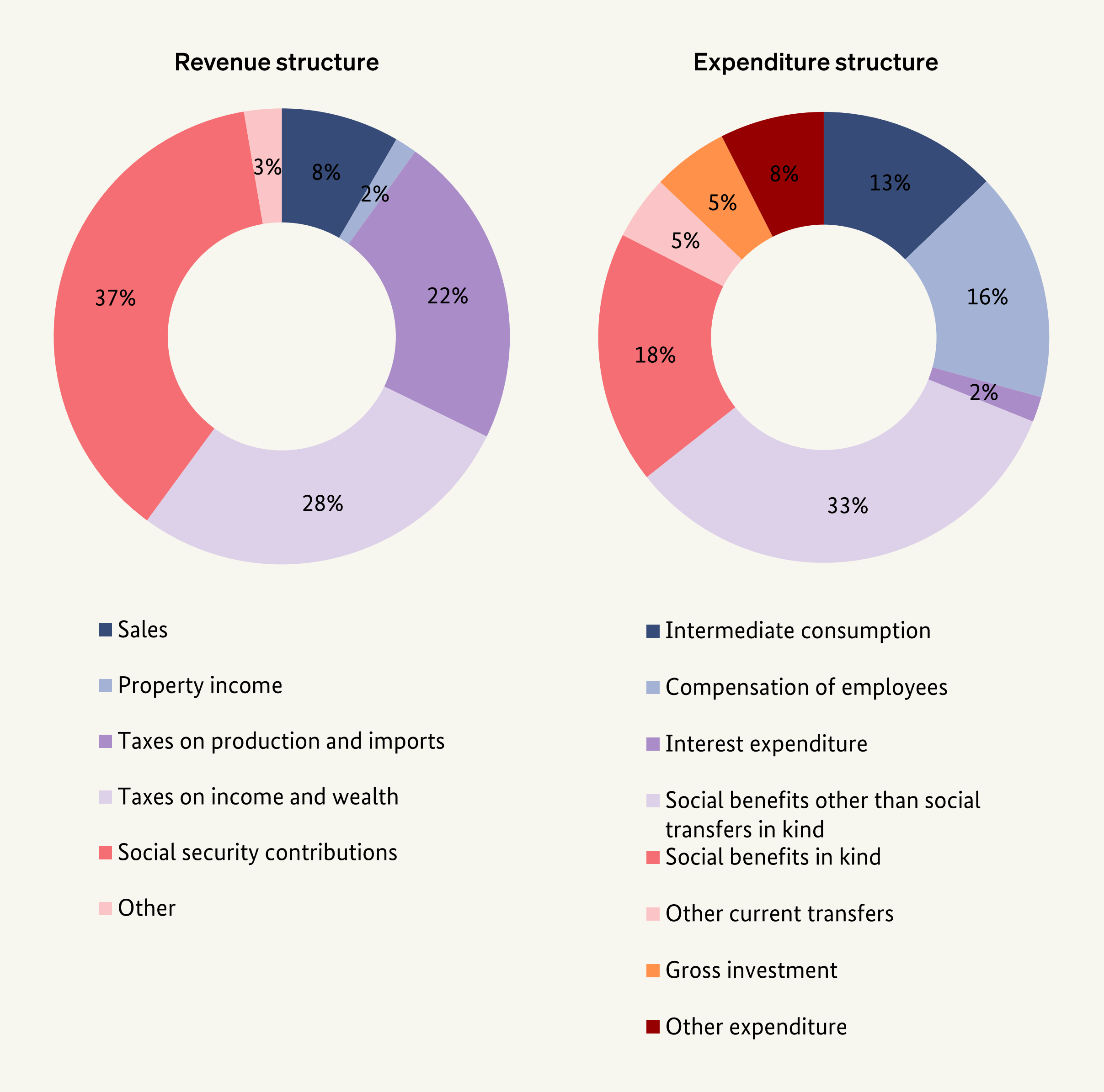
The second stage of the 2022 Inflation Compensation Act (*Inflationsausgleichsgesetz 2022*) provides citizens with relief totalling €14.2bn in 2024. Its main components are an increase of the basic personal allowance to €11,604, an increase of the tax allowance for children to €6,384, and adjustments to the tax bracket thresholds (with the exception of the maximum tax rate) to offset bracket creep. In addition, the solidarity surcharge threshold is being raised. The threshold applies to the taxes that make up the tax base of the solidarity surcharge, i.e. wages tax or assessed income tax. As of 2024, the threshold is being raised to €18,130 for individual filers and €36,260 for joint filers. This change also results in a shift in the reduced-liability range, providing relief to taxpayers who pay a reduced solidarity surcharge on their wages/income tax. The maximum deduction for maintenance payments is also being increased. Due to the significant increases in prices and wages that are relevant for standard benefit rates, a further increase in the subsistence income as defined for tax purposes is necessary in 2024. This provides additional substantial relief for income tax payers.

The agreement on the two-pillar solution to reform international corporate taxation represents a major, globally coordinated step towards greater tax fairness and the establishment of appropriate global taxation levels for multinational corporations. The reforms are comprised of two pillars. Pillar 1 involves the partial reallocation of rights to collect tax from the world's largest and most profitable corporations. As a result, (digital) corporations will in future pay tax where their customers or users are located. The second pillar is the global minimum effective tax rate, which aims to put an end to aggressive tax planning and harmful tax competition. In future, corporate groups with group-wide revenue of more than €750m will pay an effective rate of tax of at least 15% on their profits, regardless of where

their business units are located. The two-pillar solution is now being implemented step by step. The Pillar 2 Directive was adopted to ensure uniform implementation within the EU. EU member states were required to transpose it into national law by 31 December 2023. Germany completed the implementation of the global minimum effective tax rate in late 2023 with the promulgation of the Minimum Tax Act (*Mindeststeuergesetz*) in the Federal Law Gazette. The rules apply for the first time to fiscal years starting after 30 December 2023.

General government revenue and expenditure structure in 2023

Figure 5



Source: Federal Statistical Office, March 2024

Note: Totals may exceed 100% due to rounding.

3.4 Implementation of country-specific fiscal policy recommendations

As part of the European Semester, the Commission assesses the economic and fiscal policies of the EU member states annually and submits recommendations. Its analysis draws on the national reform programmes as well as the stability and convergence programmes. The European Council agreed on the country-specific recommendations for 2023 and 2024 on 16 June 2023. With regard to German fiscal policy, the Council recommends that Germany wind down the support measures introduced in response to the energy crisis as soon as possible and use the related savings to reduce the government deficit. Should renewed support measures be necessary, these should be targeted at protecting vulnerable households and firms and preserve incentives for energy savings. Germany should ensure prudent fiscal policy, in particular by limiting the nominal increase in nationally financed net primary expenditure in 2024 to no more than 2.5% (based on an improvement in the structural balance of 0.3% of GDP).

The Council further recommends that Germany preserve public investment, implement public investment initiatives as planned and ensure the effective absorption of RRF grants and other EU funds, in particular to foster the green and digital transitions. Germany should pursue a fiscal strategy of gradual and sustainable consolidation, combined with investments and reforms conducive to sustainable growth, to achieve a prudent medium-term fiscal position. The tax mix should result in more inclusive and sustainable growth, in particular by improving tax incentives to increase hours worked. Germany should safeguard the long-term sustainability of the pension system. In addition, the Council recommends that the implementation of the DARP be accelerated significantly, including the swift finalisation of the addendum and the REPowerEU chapter.

In terms of structural policy, the Council recommends that Germany speed up the digitalisation of the entire service chain for public services, improve people's digital skills, remove investment obstacles and boost investment in very high capacity digital communication networks. In the area of energy policy, Germany should increase its efforts to further reduce the overall reliance on fossil fuels, especially by means of investment in renewable energy and in electricity networks as well as improved administrative capacity and streamlined processes. The Council recommends that Germany step up energy efficiency efforts in transport, building and industry, including through investments in heating systems and further policy measures aimed at the provision and acquisition of the skills needed for the green transition.

The federal government's fiscal and economic policy agenda is consistent with the country-specific recommendations. The federal government continues to pursue a prudent fiscal policy with a core focus on fiscal resilience. In order to maintain fiscal capacity in the event of future crises, and in light of the major medium-term challenges facing the German economy, the general government deficit and the debt-to-GDP ratio will be gradually reduced over the coming years in a cyclically appropriate manner. The anticipated increase in government net primary expenditure is above the maximum level of 2.5% specified in the country-specific recommendations of summer 2023. However, the structural balance improvement of 0.3 percentage points on which this recommendation is based will be achieved nonetheless. This approach marks a fiscal policy normalisation that is reflected in the federal budget for 2024. It is complemented by a comprehensive and targeted supply-side economic and fiscal policy aimed at boosting Germany's growth potential and preventing additional inflationary pressures (see also Chapter 3.2).

To this end, the federal government is providing tax policy stimuli that are in line with the country-specific recommendations. The Growth Opportunities Act enhances

the German economy's productiveness and competitiveness. It contains numerous measures that enhance business liquidity and improve conditions for investment and innovation (see Chapter 3.3). The Financing for the Future Act, which came into force at the end of 2023, will make a major contribution to mobilising private capital for investment and innovation, making Germany a stronger magnet for the financial sector, and deepening Germany's capital market (see Chapter 3.3). The basic allowance for young people up to the age of 25 has been raised to the minimum income limit, and the tax allowance for people earning between €520 and €1,000 per month has been increased from 20% to 30%. This creates greater incentives for people to take on jobs subject to social security contributions or to extend the hours they work. To enhance mutual responsibility between spouses, Germany's governing parties declared in their coalition agreement that the combination of tax classes III and V for spouses would be replaced with the factor-based method under tax class IV. This will distribute the income tax burden between spouses more evenly, based on each individual's own wages, which in turn will give low-income earners and second earners a stronger incentive to enter employment or increase their working hours

The Pensions Package II includes a "generational capital fund" that aims to expand the funding base for the statutory pension insurance system while simultaneously stabilising pension levels over the long term. In addition to federal pension contributions and federal payments, the statutory pension insurance system will in the future also be financed through returns on a capital stock managed by a public body. By financing part of the statutory pension system, the fund will help to mitigate future increases in pension contribution rates. Moreover, the federal government has set itself the goal of strengthening occupational pensions and conducting a fundamental reform of the private pension system. The legislative process will take into account recommendations that were put forward in the first half of 2023 by an expert group on occupational pensions and a focus group on private pensions whose members included representatives from social partners, associations and the research community. One of the shared objectives of these three initiatives is to make greater use of the opportunities presented by international capital markets in order to safeguard the long-term sustainability of pension systems.

4. General government budget balance and debt level projection

The projection set out below for the budgetary trends at all levels of government is based on the following:

- 2024 federal budget (dated 12 February 2024) and the Federation's fiscal plan to 2027 (dated 5 July 2023)
- Federal government annual projection on macroeconomic trends (dated 21 February 2024)
- Results of the Working Party on Tax Revenue Estimates of 24–26 October 2023, technically adjusted on the basis of the annual projection
- Estimate of the budgetary trends of the *Länder*, local authorities and social security funds, updated on the basis of the actual results for 2023 and the annual projection
- The estimate for 2028 was made by rolling over the 2027 figures for the Federation by analogy with the budgetary procedure.
- Technical assumptions were made to adjust the Climate and Transformation Fund's economic plan to the reduced reserves as a result of the Federal Constitutional Court's judgment of 15 November 2023.

The reference date for the projection is 28 March 2024.

4.1 Trends in general government revenue and expenditure

Revenue ratio will increase over the projection period

The revenue ratio, which measures government revenue as a percentage of GDP, totalled 46.1% of GDP in 2023, a decline from 47.0% in 2022. It is expected to rise over the projection period due to increases in the social contribution ratio and the tax-to-GDP ratio. The projected rise in the tax-to-GDP ratio is partly a result of carbon price increases; carbon price receipts are recorded as tax revenue under the European System of Accounts (ESA). Another factor is the phasing-out of crisis-related measures. For example, the temporary reduction in VAT rates on gas and district heating will cease to apply in spring 2024, and the depreciation relief on goods purchased during the pandemic years will have a progressively lower impact on tax receipts in subsequent years.

Trends in the government revenue ratio Table 1

	2023	2024	2025	2026	2027	2028
	% of GDP					
Taxes	23.1	23½	23¾	24¼	24½	24½
Social security contributions	17.2	17¾	18	18¼	18¼	18¾
Taxes and social security contributions	40.6	41¼	42¼	42½	43	43½
Total revenue						
April 2024 update	**46.1**	**47**	**47½**	**48**	**48**	**48½**
April 2023 update	45¾	46	46½	46¾	-	-

The tax-to-GDP ratio relates to current taxes. The ratio for taxes and social security contributions also includes capital taxes. Figures for the projection period are rounded to one quarter of a percentage point of GDP.

The fact that the projected revenue ratio is higher than forecast in the April 2023 update of the Stability Programme is unrelated to the increased tax-to-GDP ratio (in fact, the projected tax-to-GDP ratio is somewhat lower than forecast in 2023). Rather, it is a result of rises in the social contribution ratio and other revenue. The latter is in turn largely attributable to a statistical special effect: since May 2023, local public transport has been recorded as part of the government sector under the ESA. This reclassification has resulted in increased government revenue and expenditure (but has had little effect on the budget balance). The change was not yet reflected in the April 2023 update of the Stability Programme. The reclassification will also contribute to the year-on-year rise in revenue in 2024, since 2024 is the first year in which local public transport will be classified under the government sector for a full twelve months.

Government expenditure ratio declined in 2023, but will increase over the projection period

The government expenditure ratio, which measures government expenditure as a percentage of GDP, stood at 48.6% of GDP in 2023, down from 49.5% in 2022. This is primarily due to the phasing-out of measures taken in response to the Covid-19 crisis. The fact that the government expenditure ratio was lower in 2023 than projected in the April 2023 update of the Stability Programme is due to lower outflows of funds than anticipated, especially for the Economic Stabilisation Fund (Energy) and the Climate and Transformation Fund.

The government expenditure ratio is expected to rise over the projection period. In 2024, the rise will be driven primarily by the special fund for the Bundeswehr, the Climate and Transformation Fund, the social security funds and the statistical special effect related to local public transport described above. The increase will be mitigated in particular by the discontinuation of the crisis-related energy price brakes. In subsequent years, the social security funds and the special fund for the Bundeswehr will be the main drivers of the rise in the government expenditure ratio. Interest expenditure is also expected to increase over the projection period due to higher interest rates.

The expiry of the Economic Stabilisation Fund (Energy) will result in a substantial year-on-year decline in subsidies in 2024. In contrast, government gross fixed capital formation will remain on a positive trajectory, with an average rise of approximately 4½% per year over the projection period. This is a greater increase than that of nominal potential output, which is projected to rise by an average of 2.7% per year.

The government expenditure ratio over the projection period is higher than estimated in the previous Stability Programme partly as a result of the above-mentioned statistical special effect related to local public transport.

Trends in the government expenditure ratio

Table 2

	2023	2024	2025	2026	2027	2028
	% of GDP					
April 2024 update	**48,6**	**48¾**	**48¾**	**49¼**	**49½**	**49½**
April 2023 update	50	47¾	47¼	47¼	-	-

Figures for the projection period are rounded to a quarter of a percentage point of GDP.

4.2 Trends in the general government budget balance

The general government budget balance is projected to improve from -2.5% of GDP in 2023 to -1¾% of GDP in 2024. The expiry of crisis-related measures, especially the Economic Stabilisation Fund (Energy), plays a key role here and will result in a projected reduction of the deficit in line with the country-specific recommendations. This reduction will be slowed by higher deficits for the Climate and Transformation Fund and the special fund for the Bundeswehr. The general government deficit is projected to decline further to 1% of GDP in 2025, partly as a result of the technical assumption of a reduced Climate and Transformation Fund deficit. By the end of the projection period, the general government deficit is expected to stand at 1% of GDP. The projected increases in 2026 and 2027 are primarily attributable to the social security funds.

4.3 Trends in the general government structural balance

Structural consolidation in 2024 and 2025

Fiscal policy influences the general government budget balance mainly through budget policy, i.e. the management of revenue and expenditure. At the same time, however, the general government budget balance is affected by a number of cyclical and exceptional factors that lie largely outside the direct control of governments. For this reason, EU budgetary surveillance looks at structural indicators in order to assess fiscal policy in a manner that excludes these factors. The structural budget balance is the balance adjusted for one-off effects and the cyclical component.

The structural budget balance stood at -2.0% of GDP in 2023. It is projected to improve gradually in 2024 and 2025, in line with the strategic focus of German fiscal policy. This projected improvement is consistent with a moderately restrictive fiscal stance, which is in line with the EU recommendations. Slight structural deteriorations are expected in 2026 and 2027, especially for the social security funds.

Trends in the general government budget balance Table 3

	2023	2024	2025	2026	2027	2028
	% of GDP					
April 2024 projection	**-2.5**	**-1¼**	**-1**	**-1¼**	**-1½**	**-1**
April 2023 projection	-4¼	-1¾	-¾	-¾	-	-

Figures for the projection period are rounded to a quarter of a percentage point of GDP.

Budget balances according to government level Table 4

	2023	2024	2025	2026	2027	2028
	% of GDP					
Central government	-2.3	-1¼	-¾	-¾	-½	-½
State government	-0.2	-¼	-¼	-¼	-¼	0
Local government	-0.3	-¼	-¼	-¼	-¼	-¼
Social security funds	0.2	0	0	-¼	-½	-¼
General government	**-2.5**	**-1¾**	**-1**	**-1¼**	**-1½**	**-1**

Figures for the projection period are rounded to a quarter of a percentage point of GDP. Differences between the general government budget balance and the budget balances of the various levels of government are due to rounding.

Structural budget balance compared with actual budget balance and GDP trend

Table 5

	2023	2024	2025	2026	2027	2028
	% of GDP					
Structural budget balance	**-2.0**	**-1¼**	**-¾**	**-1**	**-1¼**	**-1**
Actual budget balance	-2.5	-1¾	-1	-1¼	-1½	-1
	% change yoy					
Real GDP	-0.3	0.2	1.0	0.7	0.7	0.7

Figures for the projection period are rounded to a quarter of a percentage point of GDP.

The medium-term budgetary objective for the structural budget balance (based on the Stability and Growth Pact rules that have applied up to now) of -0.5% of GDP will not be reached within the projection period. However, the usual benchmark for the reduction of the structural deficit under the current Stability and Growth Pact – 0.5 percentage points per year – will be achieved.

The new rules under the revised the Stability and Growth Pact will enter into force in 2024. Germany's precise fiscal targets for the coming years will be defined in the medium-term fiscal-structural plan (FSP).

Trends in government expenditure (using the expenditure benchmark definition)

In addition to the medium-term objective, the preventive arm of the current Stability and Growth Pact also includes an expenditure benchmark. For the purposes of the expenditure benchmark, expenditure is adjusted for various items including interest expenditure, cyclical labour market effects, deviations in investment spending from the average investment level, expenditure financed by EU programmes and the effects of discretionary measures on revenue.

Expenditure (using the expenditure benchmark definition) increased by 5.7% on the year in 2023 and thus significantly more slowly than averaged nominal potential GDP growth[3], which is an important comparator under the current Stability and Growth Pact.

Expenditure growth (using the expenditure benchmark definition) is expected to total 3% in 2024. The projected figure for subsequent years is lower. The above-mentioned special effect related to local public transport will contribute to expenditure growth. Overall, expenditure growth is projected to be below averaged nominal potential GDP growth but above the maximum level of 2.5% set out in the country-specific recommendations for 2024 that were issued in summer 2023. However, the recommendation was based on a structural budget balance improvement of 0.3 percentage points, a target that will nonetheless be achieved, according to the projection (see previous table).

The requirements under the reformed Stability and Growth Pact rules will not be defined until autumn 2024 as part of the FSP.

3 Averaged nominal potential GDP growth is calculated in a way that is analogous to the Vade Mecum (2019): real potential GDP growth is averaged over a ten-year period, and the GDP deflator for the year in question is then added.

Expenditure benchmark: projected expenditure and potential output

Table 6

	2023	2024	2025	2026	2027	2028
	in relation to GDP (%)					
Expenditure (yoy increase; according to the expenditure benchmark definition)	5.7	3¾	2¼	3¼	3	2½
Nominal potential GDP growth (moving 10-year annual average)	7.4	3.9	2.3	2.5	2.5	2.5

Figures for the projection period are rounded to a quarter of a percentage point of GDP.

4.4 Sensitivity of the budget balance projection

Sensitivity analyses can provide indications of how a projected trend is affected under altered conditions. The model used to analyse the budget balance's sensitivity to changes in GDP and interest rates thus takes into account the fact that the underlying macroeconomic assumptions are subject to uncertainty. For each sensitivity analysis, two alternative scenarios are considered. All other assumptions remain unchanged.

For the purposes of the GDP sensitivity analysis, government revenue and expenditure are assumed to respond to the GDP scenarios in a manner consistent with their long-term elasticity. The budget semi-elasticity used in the context of the European budgetary surveillance process is applied for this purpose. Under the positive alternative scenario – that is, if real GDP growth were to exceed the federal government's annual projection (the baseline scenario) by half a percentage point per year – under otherwise identical assumptions the general government budget balance would be positive again by the end of the projection period. Under the second alternative scenario, in which the annual rate of change of real GDP is assumed to be half a percentage point lower than in the baseline scenario, the general government budget balance by the end of the projection period would be similar to the level recorded in 2023.

If the market interest rate were to be 50 basis points p.a. higher than under the baseline scenario (which would then be gradually reflected in the implicit interest rate), the general government budget deficit during the projection period would be up to one quarter of a percentage point of GDP p.a. higher. Under the second alternative scenario – that is, if the market interest rate were to be 50 basis points lower – the general government budget deficit would be up to one quarter of a percentage point of GDP p.a. below the projected values in the baseline scenario.

GDP sensitivity of the general government budget balance projection

Table 7a

GDP trends according to	2023	2024	2025	2026	2027	2028
	General government budget balance in % of GDP					
- Baseline scenario	**-2.5**	**-1¾**	**-1**	**-1¼**	**-1½**	**-1**
- Alternative scenarios						
real GDP growth ½ pp p.a. below baseline		-2	-1½	-2	-2½	-2¼
real GDP growth ½ pp p.a. above baseline		-1½	-½	-½	-½	¼

Figures for the projection period are rounded to a quarter of a percentage point of GDP.

Interest rate sensitivity of the general government budget balance projection

Table 7b

Interest rate trends according to	2023	2024	2025	2026	2027	2028
	General government budget balance in % of GDP					
- Baseline scenario	**-2.5**	**-1¾**	**-1**	**-1¼**	**-1½**	**-1**
- Alternative scenarios						
Interest rate ½ pp p.a. below baseline		-1¾	-1	-1	-1¼	-¾
Interest rate ½ pp p.a. above baseline		-2	-1¼	-1¼	-1½	-1

Figures for the projection period are rounded to a quarter of a percentage point of GDP.

4.5 Trends in the debt-to-GDP ratio

From 2013 to 2019, Germany's debt-to-GDP ratio (that is, Maastricht gross debt relative to GDP) saw a steady decline. By the end of 2019, it stood at 59.6%. This means that it was below the Maastricht reference value of 60% for the first time since 2002. The decline in the debt-to-GDP ratio during the years prior to the Covid-19 pandemic and Russia's invasion of Ukraine helped to put Germany in a position to deliver a strong and decisive response to the ensuing crises without compromising the sustainability of public finances. As a result of the measures taken to combat the pandemic, the debt-to-GDP ratio rose to a peak of 69.3% by the end of 2021. In 2022, despite a general government budget deficit, the debt-to-GDP ratio fell significantly to 66.3%, thanks to the high rate of nominal GDP growth.

This trend continued in 2023, with a further substantial reduction of the debt-to-GDP ratio to 63.6%. This was essentially due to two effects: first, borrowing on the capital markets in 2022 exceeded budgetary requirements as a result of the uncertain budgetary situation, which reduced new borrowing in 2023; second, the high nominal GDP growth in 2023 significantly lowered the debt-to-GDP ratio. Ultimately, the lower level of new borrowing was made possible by the repayment of loans that were made to support utility companies and stabilise the economy during the Covid-19 pandemic.

The debt-to-GDP ratio is projected to rise slightly in 2024, to approximately 64%. The Maastricht debt-to-GDP ratio describes the aggregate gross debt of public budgets; it is not netted against government assets. The main factor driving the trend in the debt-to-GDP ratio is new cash borrowing by public budgets. Spending on financial transactions has the effect of increasing the Maastricht debt-to-GDP ratio, unlike in the case of the Maastricht deficit. This means that building up the generational capital fund, for example, will increase the Maastricht debt-to-GDP ratio, which will consequently be ¼% higher in 2024 than would have been the case without the generational capital fund. From 2025 onwards, the debt-to-GDP ratio is projected to decline again. By the end of the projection period in 2028, it is expected to stand at approximately 62%. The projected trend in the Maastricht debt-to-GDP ratio reflects the federal government's prudent fiscal policies and its aims of maintaining fiscal resilience, strengthening the sustainability of public finances and building fiscal buffers.

Trends in the general government debt-to-GDP ratio

Table 8

	2023	2024	2025	2026	2027	2028
	% of GDP					
April 2024 projection	**63.6**	**64**	**63¼**	**63¼**	**63**	**62**
April 2023 projection	67¾	66½	66¼	65½	-	-

Figures for the projection period are rounded to a quarter of a percentage point of GDP.

5. Long-term sustainability and quality of public finances

5.1 Challenges to the sustainability of public finances

Demographic change is one of the main challenges to the long-term sustainability of public finances in Germany. In the 2020s and 2030s, the number of people of retirement age will increase significantly both in absolute terms and in relation to the number of people of working age (see the left side of Figure 6). The number of people of retirement age (65 years and older) per 100 people of working age (15 to 64 years) already increased from approximately 22 to about 35 between 1990 and 2023. This ratio (commonly referred to as the old-age dependency ratio) is projected to exceed 41 by 2030 and is expected to provisionally plateau at around 45 by the late 2030s (see the right side of Figure 6).

The increase in the old-age dependency ratio is due to two opposing trends in the composition of the population: a rise in the number of people of retirement age, which is partly due to increasing life expectancy, and a fall in the number of people of working age. The latter is due to the fact that births and immigration are not fully making up for the number of baby boomers moving into retirement. Based on the birth rate, life expectancy and migration assumptions of the middle variant of the Federal Statistical Office's 15th coordinated population projection, it is expected that the number of people of retirement age (65 or over) will have risen by around 4 million to a projected 22 million people by the mid-2030s. In the decades after that, the number of people over the age of 65 will remain relatively stable up to the projection horizon of 2070. According to the projection, the number of people of working age will fall by around 3.2 million to about 50 million in the period up to the mid-2030s.

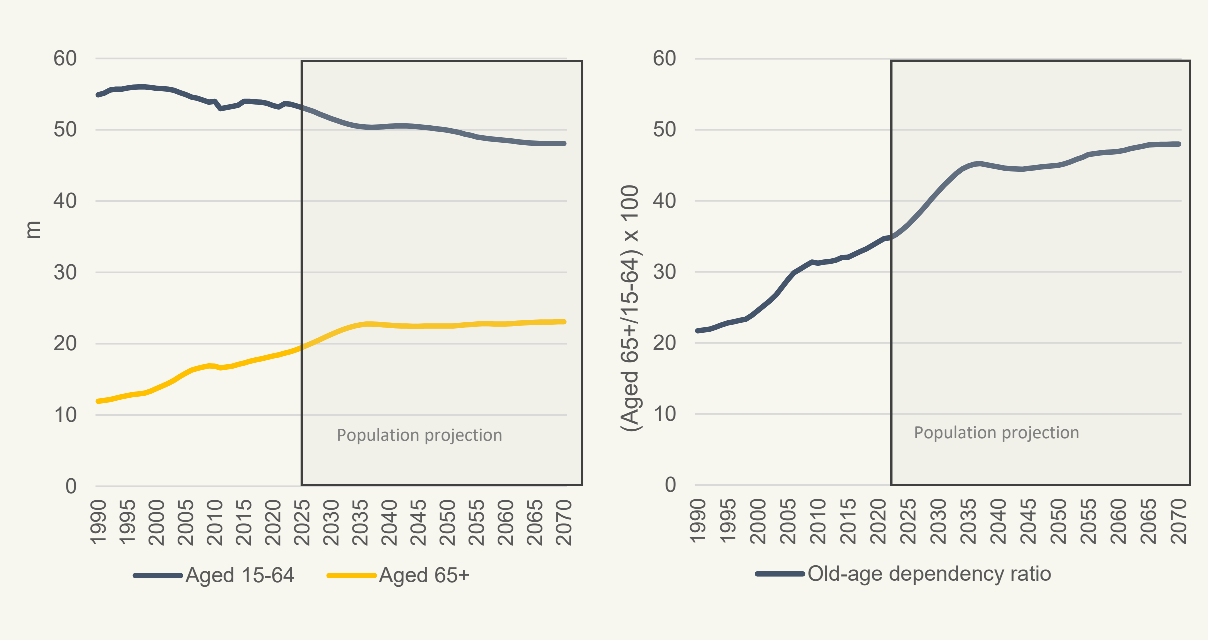
As a result, the economy will have significantly fewer workers at its disposal in the medium and long term, due to older workers exiting the labour market. This trend will not only have an impact on the funding of Germany's social welfare systems but will also affect the German economy, which relies on well-trained skilled workers.

Demographic change also affects the trend in overall potential output. According to federal government estimates, potential output growth is expected to decline from 0.7% in 2023 to 0.5% in 2028. One key reason for this is the decreasing (and, in the medium-term projection period, negative) contribution of labour to growth (see Figure 7), which is connected to the decline in the potential workforce as a consequence of demographic change.

Efficient, forward-looking fiscal and economic policies aimed at boosting aggregate supply and economic productivity can mitigate the effects of the projected decline in potential output growth. One way to increase potential output is to improve conditions for mobilising investment and enhancing competition. Better conditions for research and development would also have a favourable effect on companies' innovative capacity, thereby increasing the long-term potential growth of the German economy. Not least importantly, it is essential to maximise the labour force participation of German and foreign workers even more in the future, and to implement measures to improve the performance potential of the working population. These measures will contribute to the soundness and long-term sustainability of public finances.

Demographic trends in Germany

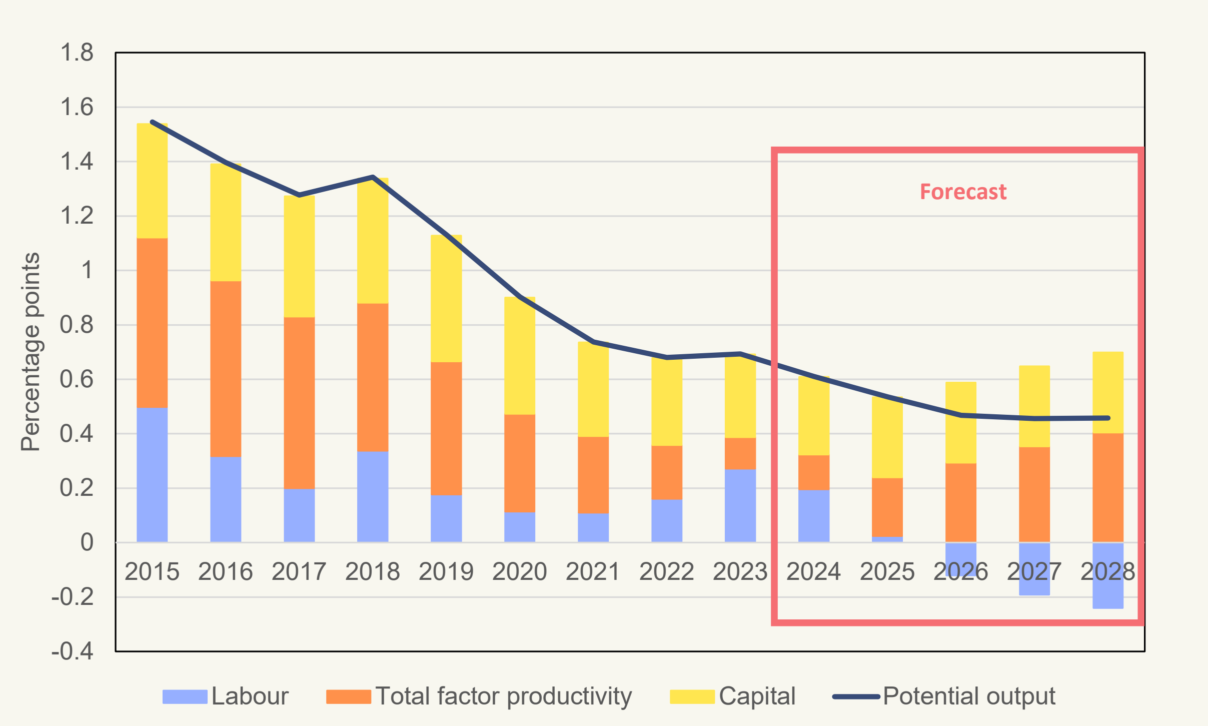
Figure 6



Source: Federal Statistical Office, 15th coordinated population projection (based on the birth rate, life expectancy and migration assumptions of the second version)

Trend in German potential output, 2015–2028

Figure 7



Source: Federal government, 2024 annual projection

5.2 Government revenue and expenditure from a long-term perspective

Comprehensive long-term projections of demographically sensitive government revenue and expenditure are needed in order to assess the long-term sustainability of Germany's public finances from a fiscal policy perspective and to assess where action needs to be taken over time. The Federal Ministry of Finance presented updated projections and an analysis of the long-term sustainability of public finances in its 2024 Sustainability Report, which was published in March 2024. The Sustainability Report is prepared once per legislative term.

The projections contained in the Sustainability Report are based on a range of assumptions regarding long-term demographic and macroeconomic trends, for example population trends and ageing, labour force participation, as well as economic growth and interest rate trends. Under the simplistic assumption that there will be no additional policy measures that affect expenditure and revenue during the projection period (no-policy-change scenario), the projections indicate that action will need to be taken over time as a result of the ageing population.

Age-related public spending could increase very significantly in the next decade and then continue to rise until 2070. In the medium and long term, expenditure on pensions, healthcare and long-term care in particular are expected to rise disproportionately.

According to projections that assume an absence of the constitutional debt brake, this will lead to a significant increase in general government debt, measured as a percentage of GDP. However, if the debt-to-GDP projection assumes that the debt brake is complied with, then this type of future development would be avoided, barring future crises (in other words, assuming there are no future exceptions to the debt brake in unusual emergency situations). Compliance with the debt brake rules therefore contributes to the long-term sustainability of public finances.

The Federal Ministry of Finance's 2024 Sustainability Report shows that fiscal sustainability has worsened in comparison with the previous Sustainability Report from 2020. The long-term projections have deteriorated despite a significantly more favourable population projection by the Federal Statistical Office (15th coordinated population projection), which forms the basis for the new projections. One reason is that the state of the German economy and public finances is considerably less favourable than it was when the last Sustainability Report was produced, as a result of the Covid-19 pandemic of 2020–2021 and the Russian invasion of Ukraine, which triggered an energy price crisis in 2022. Another reason is that the simulation period was extended from 2060 to 2070, which, given the rising demography-related spending, in itself leads to an increase in the sustainability gap. Finally, some of the modified assumptions and projection methods, which have changed since the 2020 Sustainability Report, also contribute to an increase in the sustainability gap. The updated legal situation (based on the legislation in force on 30 June 2022) also plays a role in this regard.

The sustainability gaps identified by the highly simplified projection results and their absolute values will not be used to develop direct policy recommendations. Rather, the federal government interprets the identified sustainability gaps as a sign that the soundness of public finances needs to be enhanced with a balanced mix of structural reforms and other measures in the areas of the labour market, pensions, healthcare and long-term care. In particular, higher skilled immigration and lower unemployment would have a positive impact on long-term sustainability. Similarly favourable effects would result from greater participation in the labour force by older individuals who have not yet reached retirement age as well as by women. The impact of the latter would be increased if women's average working time were also to rise in addition to their rate of labour force participation, which has already grown tangibly.

5.3 Measures to ensure long-term fiscal sustainability

The **long-term sustainability** of public finances is ensured if the state is able to meet its financial obligations over the long term. The debt brake that is enshrined in the German constitution, and the strategic orientation of German fiscal policy towards the goals of fiscal resilience and supply-side economic and fiscal policies, serve to comply with this principle. This makes it all the more significant that the 2024 federal budget once again plans for compliance with the regular upper limit for new borrowing under the constitutional **debt brake**, following four exceptional years. The debt brake acts as a guarantee for the sustainability of public finances, given that compliance with the debt brake continually requires that suitable measures be taken to tackle rising expenditure as a result of demographic change. The negotiation processes that the debt brake entails make conflicting objectives and the actual costs of increased future spending very transparent by showing that additional government services must be dispensed with.

Germany faces major structural **challenges** in the medium and long term as a result of **demographic change**. The associated decline in the labour supply will have a dampening effect on the German economy's growth potential. In addition, the foreseeable shift in the ratio of benefit recipients to contributors will have a financial impact on the social security funds. Measures to decarbonise the economy by 2045, which are necessary to meet climate goals, as well as geopolitical and geo-economic changes pose additional challenges to public finances.

The federal government is pursuing **numerous policy approaches** aimed at ensuring long-term sustainability. These cover both government revenues and spending and extend across a range of policy areas, including supply-side fiscal and economic policies, pensions, healthcare and long-term care, and family and education policies. They include structural measures to strengthen the labour supply and supply-side measures to boost the overall productivity of the economy.

The government is promoting private investment by creating **better framework conditions**. These contribute to expanding the economy's production capacity and improving economic capacity, and can increase growth potential. They also strengthen the long-term sustainability of public finances. Examples of this include the Growth Opportunities Act (*Wachstumschancengesetz*), the Financing for the Future Act (*Zukunftsfinanzierungsgesetz*, see Chapter 3.3) and raising the thresholds for determining the size classes of companies in accordance with the Accounting Directive. In addition, the federal government has presented a draft Bureaucracy Relief Act IV (*Bürokratieentlastungsgesetz IV*, the government draft of which was adopted by the federal cabinet on 13 March 2024), which will provide further relief for companies. Furthermore, a record level of public spending is planned, which will increase the quality of public infrastructure, thereby creating the right framework conditions for private **investment** and **innovation**.

The federal government considers the productivity-enhancing potential of digitalisation to be a key foundation for establishing attractive conditions for companies, for technological advances and hence for long-term economic growth. In particular, the new possibilities associated with the emerging technological revolution in the field of artificial intelligence may in future provide significant relief for the declining workforce in certain labour-intensive processes through greater automation. This also applies to the public administration: only by making comprehensive use of the opportunities created by digitalisation can the public administration provide user-friendly services to companies and citizens. The successful digitalisation of the justice system is an important building block for a modern democracy. This will create new opportunities and improve access to justice, which will strengthen the trust of businesses and civil society in the state. Alongside the digitalisation of the economy, infrastructure and education, one of the priorities of the German Recovery and Resilience Plan (DARP) is to modernise the public administration and reduce barriers to investment. Promoting digitalisation and

cutting red tape can reduce the need for labour and cut costs. The Online Access Act (*Onlinezugangsgesetz*) stipulates that the administrative services of the Federation and the *Länder* must also be offered in electronic form. With the rollout of fibre networks throughout Germany and the further expansion of mobile networks, the federal government is improving conditions for the economy to thrive. The federal government's large-scale investments in other important areas that are crucial for the future – which besides digitalisation include in particular climate neutrality and education and research – will enable long-term planning certainty, create good conditions for private investment and help companies to make full use of their growth potential.

A sustainable **revenue base** is required to ensure the long-term sustainability of public finances. A fair burden of taxes and charges, bureaucracy reduction, state and private investments and a growth-friendly competition policy are crucial to strengthening potential growth, bearing in mind the macroeconomic feedback effects of taxation levels and tax structures. Against the background of demographic change, a sustainable tax policy must be aimed at a balanced mix of direct and indirect taxes, taking into account the impact of direct taxes on income and earnings in particular. This is the only way to ensure that there are sufficient incentives to work and invest in Germany.

The **labour market** is critically important for ensuring the long-term soundness of public finances. There are a range of challenges related to Germany's ageing population that need to be addressed. One starting point for strengthening sustainability is to make even better use of the potential **domestic labour supply** in the future. To this end, the conditions for higher labour force participation and increased individual working hours need to be further improved for women, older workers and unemployed people. The ongoing **immigration** of skilled workers and their swift integration into the labour market also offers great potential to secure long-term sustainability. The federal government wants to further increase the immigration of skilled workers and their families and accelerate the integration of refugees into the labour market.

A forward-looking approach to **securing skilled labour** plays an important role in ensuring future prosperity. The baby boomer generation's gradual withdrawal from the labour market, which will continue well into the 2030s, as well as structural changes precipitated by digitalisation and decarbonisation and regional shifts in value creation and labour demand, will all contribute to shortages of skilled labour. An adequate supply of skilled workers with the appropriate qualifications is an important factor for the success of the digital transformation as well as decarbonisation. This is where the federal government's Skilled Labour Strategy comes into play. It contains statutory and administrative measures designed to support companies and businesses in their efforts to recruit and retain skilled workers. The five key priorities of the strategy are: (a) up-to-date education and training, (b) targeted continuing education and training, (c) using labour potential and increasing labour force participation, (d) improving the quality of work and work culture, and (e) modernising immigration policy and curbing emigration.

Another important way of stabilising the social security system and thereby ensuring sustainability is to increase the number of **women in employment**. Although the proportion of women in employment has risen considerably since the 1990s, overall the average employment rate continues to be lower than that of men. In addition, women, and mothers in particular, more often work part-time than men do. Mothers' average working time has continually increased in recent years, but it still significantly lower than that of fathers. This is partly due to the fact that women and mothers still take on far more responsibility for childcare and long-term care within the family. The labour force participation of mothers strongly depends on the age of their children. In 2021, only slightly more than a third of mothers of children under the age of three were in gainful employment. The corresponding figure for mothers of children between the ages of three and six was slightly above two thirds.

In both cases, the majority of mothers worked part-time. Against this background, increasing the employment rates of mothers and women (the extensive margin) offers great potential for securing social security systems and their sustainability, and this is even more true when it comes to increasing women's individual working hours (the intensive margin). Part-time management roles offer special potential and are attractive to many women facing the challenges associated with balancing family and work life. That is why the federal government has launched the model project "part-time management in supreme federal authorities". The aim is to develop guidelines as part of the 2025 Management Positions Plan. With this plan, the federal government is working towards the statutory target of achieving equal participation of women in management positions across the entire federal administration by the end of 2025.

The federal government has set itself the goal of removing the remaining obstacles that impede higher employment rates and increased working hours among women and especially mothers. The federal government believes that the best and most effective approach is to **improve basic conditions in a way that enables both men and women to achieve a good balance between family and work life** and a fair distribution of care responsibilities. The funds already provided by the federal government to assist the *Länder* in **expanding child daycare** play a particularly important role in this context. The Federation is also supporting the *Länder* in implementing the legal entitlement to **all-day care for primary school children**, which will apply from 2026 onwards (see Chapter 3.3). The coalition agreement contains further measures. For example, it sets out plans to replace the combination of tax classes III and V for spouses with the factor-based method under tax class IV. The factor-based method distributes withheld wages tax very precisely between the spouses, which should have the effect of significantly increasing the incentive for the second earner in particular to take up employment or work more. Another measure is the "family start time", which offers two weeks of paid leave for the mother's partner following the birth of a child.

Increasing **labour force participation among older people** can also help to address the sustainability issues caused by demographic trends. This can broaden the contributor base in the pay-as-you-go pension system while also limiting the increase in average pension duration resulting from rising (further) life expectancy. Furthermore, encouraging people to work longer can strengthen the financial basis of other social security funds and increase tax receipts. Not least, the experience and potential of older workers can make a valuable contribution to the world of work. Given the increasing shortages of skilled labour in Germany, this will become even more significant in the future.

The 2017 Act Facilitating a Flexible Transition from Employment into Retirement and Strengthening Prevention and Rehabilitation in Working Life, also known as the **Flexi-Pensions Act** (*Flexirentengesetz*), has improved the options for organising the transition from working life to retirement in line with employees' individual life plans. The **abolishment** as of 1 January 2023 **of supplementary income limits** for people drawing a pension before retirement age creates an additional incentive for early pension recipients to remain in employment.

Various supporting measures are intended to make it easier to remain in the labour market and make employment a more appealing prospect for people of retirement age. With the continuation and further development of the **National Skills Strategy**, the federal government is underscoring the importance of further training and skills development. In cooperation with the *Länder*, industry associations and social partners, as well as the Federal Employment Agency, it is pursuing the goal of maintaining and expanding the long-term employability of workers against the background of the digital transition, providing individual development and advancement prospects, and strengthening the innovative capacity and competitiveness of businesses.

A **social dialogue** will be conducted with the social partners on how to make it easier for people to stay in employment for longer if

they wish. The aim is to identify and remove obstacles that prevent people from remaining in work for longer on a voluntary basis and to create incentives that encourage people above the age of 60 to remain in employment.

To boost the labour supply and, in particular, increase the number of hours actually worked, **employment incentives for low-income workers** can be created, for example through changes to the tax and transfer system.

Allowing skilled workers to **immigrate** and remain in Germany is an important factor in dealing with skills shortages, demographic ageing and the associated challenges for the sustainability of public finances. Because migrants tend to be younger than the native population on average, continuous net immigration counteracts demographic ageing.

A permanent labour force participation of immigrants is important in order to ensure long-term sustainability. The orderly, **ongoing immigration** of people who wish to take up work and remain for long periods of time is particularly advantageous in this respect. The sustainable labour market integration of refugees can also make a positive contribution. Factors such as immigrants' age distribution, education or qualification levels, quick labour market integration as well as duration of stay play a key role when it comes to the favourable effects of immigration. Tax conditions in Germany are also relevant in this context, as they can affect the migration decisions of highly qualified workers.

The demographic and socio-economic composition of **refugees from Ukraine** offers good prerequisites for successful labour market integration. Following initial restraint, the labour force participation of Ukrainian refugees is now showing a positive trend. Nonetheless, this potential could be tapped even more effectively through swifter labour market integration, which would help strengthen long-term sustainability. The more quickly and successfully people are integrated in the labour market and in society, the greater the positive effects on sustainability. This is where the "job turbo" plan of action comes into play, which was announced in October 2023 (see Chapter 3.3).

Although by international standards Germany already has a modern and open immigration system for skilled workers from third countries, it remains the case that not enough skilled workers from outside the EU use the immigration opportunities that exist. The **Skilled Immigration Act** (*Fachkräfteeinwanderungsgesetz*) has been developed further in order to make it easier for people with vocational qualifications to enter the German labour market. Promulgated in August 2023, the law and the corresponding ordinance consist of several parts which will enter into force in stages (see Chapter 3.3).

Demographic ageing poses a major challenge, particularly in the area of **pensions**. Sustainable financing of statutory pensions and people's confidence in their entitlement to an adequate pension in old age need to be kept in balance. Important measures have already been implemented in recent years to address these foreseeable demographic challenges. For example, the incremental increase of the standard retirement age to 67 by 2031 will contribute to an intergenerational balance between those receiving a pension and those paying contributions.

Thanks to favourable employment trends, the finances of the statutory pension insurance system have improved continuously in recent years compared with previous projections. By the end of 2022, the sustainability reserve of the general pension insurance system had increased by nearly €3.8bn on the year, to approximately €42.8bn. The total revenue from contributions collected by the general pension insurance scheme from January to September 2023 increased by 5.4% compared with the same period in 2022. The sustainability reserve is expected to have increased once again in 2023.

The **contribution rate** for statutory pension insurance has stood at 18.6% since 2018. In 2023, the **replacement rate** before tax was 48.2%. Demographic change will necessitate

a rise in the contribution rates for statutory pension insurance. Based on the statutory adjustment rules, this will also lead to a corresponding rise in federal transfers to the statutory pension system. Under the current legal situation, it can be expected that the income replacement rate before tax will decline steadily as a result of the expiry of the commitment to maintain pension levels at 48% based on the pension adjustment formula.

To ensure sustainable financing of the statutory pension system and to maintain intergenerational equity, the Act Adjusting Pensions for 2022 and Improving Pension Benefits for Persons with Reduced Earning Capacity (*Gesetz zur Rentenanpassung 2022 und zur Verbesserung von Leistungen für den Erwerbsminderungsrentenbestand*) reintroduced, among other things, the "**catch-up factor**" in pension calculations. The pension reduction that was not applied in 2021 due to the economic effects of the Covid-19 pandemic was taken into account in the pension increase in 2022. This has reduced pension levels, which has had a favourable effect on the expenditures of the statutory pension system.

According to the Pensions Package II, the aim is to maintain the pension level in the statutory pension system at 48% beyond 2025. In order to mitigate rises in contribution rates over the long term, the statutory pension system is to be financed in part through investments in capital markets (alongside contributions and federal government payments). According to the government's plans, the "**generational capital fund**" will be professionally managed as a permanent fund with a global focus by an independent public body. The 2024 federal budget includes expenditure totalling €12bn for a loan that will be used to build up the fund. Over the coming years, the loan-financed allocations are due to increase by 3% every year, reaching a total capital stock of €200bn by the mid-2030s. The loan-financed allocations are financial transactions as defined in section 3 of the Article 115 Act (*Artikel-115-Gesetz*), meaning that they are recorded as net borrowing but do not affect the Federation's assets and do not count towards the borrowing limits set out in Article 115 of the Basic Law. The proceeds from the generational capital fund will accrue to the statutory pension insurance system starting in the mid-2030s. They will help to contain rises in contribution rates and thus act as a permanent financing component for the statutory pension insurance system that is less dependent on demographic trends.

The other two pillars of old-age provision in Germany – **occupational pensions and private pensions** – will also be strengthened in 2024 by means of reforms. In the area of occupational pensions, specific adjustments to the social partnership model, the investment ordinance and cover rules are planned in order to make occupational pensions more widespread and enable higher-return investments. The proposed fundamental reform of the private pension system will be based on the recommendations that were issued by the "private pension focus group" in summer 2023. The key recommendations are (a) more promising investment options (e.g. in the form of a tax-incentivised, low-cost securities account aimed at retirement provision), (b) greater transparency (e.g. through a digital comparison platform for supported products) and (c) enhanced flexibility (e.g. for the disbursement phase and changes of providers).

In order for people to feel secure about their old-age provision, it is important that they have easy access to information about their accrued entitlements from statutory, occupational and private pensions. This enables them to make informed decisions about their old-age provision that suit their life circumstances. To this end, the Central Office for the Digital Pensions Overview at Deutsche Rentenversicherung Bund implemented the **digital pension overview** in 2023 under the Pensions Overview Act (*Rentenübersichtsgesetz*). Since summer 2023, all citizens have been able to access the portal and use the new service. From 31 December 2024 onwards, additional pension institutions will be required to join the portal, meaning that there will be more information available.

An initiative to strengthen **financial literacy** will improve people's understanding of fundamental financial concepts and financial

products, not just in the area of pensions. In particular, the central “Mit Geld und Verstand” financial literacy platform bundles existing financial literacy tools in user-friendly formats, tailored to the needs of different user groups. A first version of the platform has been online since December 2023. The aim is to increase financial literacy among all sectors of the population, thus enhancing people’s confidence to participate fully in economic life on a long-term basis.

Structural reforms of the **healthcare system** are needed in order to achieve stable and reliable financing of the statutory health insurance system, thus ensuring its long-term sustainability. In 2023, the federal government met this challenge by introducing a raft of temporary stabilisation measures that make use of financial reserves in the statutory health insurance funds, efficiency reserves in the provision of services, a one-off additional federal subsidy and a one-off loan from the federal budget to the statutory health insurance funds. This prevented high increases in contributions while simultaneously maintaining high quality standards in healthcare.

In the medium to long term, the structural reforms to the statutory healthcare system that the federal government is planning to implement or has already implemented will make the provision of services more efficient by focusing on the expenditure side in particular. This will help to ensure that healthcare can be financed in a sustainable and socially equitable way. For example, with the Act to Accelerate the Digitalisation of Healthcare (*Gesetz zur Beschleunigung der Digitalisierung des Gesundheitswesens*) and the Act on the Use of Health Data (*Gesundheitsdatennutzungsgesetz*), the federal government launched a range of measures in 2023 to reduce unnecessary bureaucracy in the healthcare system. From 2025 onwards, the Act to Accelerate the Digitalisation of Healthcare will establish a system of patient electronic medical records in the statutory pension insurance system that will enhance the exchange and use of healthcare data and thus improve the provision of healthcare in a targeted way. Building on the electronic patient records and the electronic prescriptions that have already been introduced, the entire medication process is being digitalised, making it more efficient, user-friendly and secure for patients, doctors and pharmacies.

In particular, expanding cross-sector care services as well as increasing outpatient provision of previously inpatient treatments, while maintaining the same high quality of care, can lead to a less cost-intensive provision of services. Reform outlines based on the criteria of accessibility and demographic trends are currently being developed by, among others, the Government Commission for Modern and Needs-Based Hospital Care at the Federal Ministry of Health. Some of these reforms are already being implemented.

In the area of **long-term care insurance**, the federal government is reviewing the details of a package of measures aimed at sustainably financing care services and stabilising the financial situation of long-term care insurance. In accordance with the explanatory memorandum to the Long-Term Care Support and Relief Act (*Pflegeunterstützungs- und -entlastungsgesetz*), which was adopted by the Bundestag in June 2023, the Federal Ministry of Health will issue recommendations for the stable and permanent financing of long-term care insurance by the end of May 2024, with a particular emphasis on the expenditure side of the long-term care insurance system.

In view of the expected demographic trends and the projected decline in labour’s contribution to overall potential output, further improvements in the areas of school **education as well as initial and continuing education and training** are essential. Education and skills development begin in early childhood and extend throughout a person’s working life. Ensuring that the workforce has the skills needed for the future requires a strong education system with good schools, a robust vocational training system and a competitive higher education system. Moreover, continuous professional development and training for employees plays an important role in ensuring that people enjoy a long and productive working life.

One of the federal government's main aims is to increase educational equity and to ensure that the educational opportunities of children and young people are not dependent on their parents' social situation. The proposed "Startchancen" programme for a better educational start in life is an important part of this. According to current plans, its implementation will start in the 2024/2025 school year. The programme will be aimed at approximately 4,000 general education and vocational schools along the education chain that are facing challenging situations. The aim of the "Startchancen" programme is to initiate structural changes (within the framework of the government's constitutional responsibilities) that will have a long-term impact.

The 27th Act Amending the Federal Training Assistance Act (*27. BAföG-Änderungsgesetz*), which came into force in 2022, made training assistance (federal training assistance and upgrading assistance) more attractive by providing substantial benefit increases. In addition, an Excellence Initiative for Vocational Training will inject new momentum into initial and continuing vocational training. The aim is to meet the growing future demand for skilled workers, provide the best possible individual educational opportunities, and ensure that people can enjoy long and productive working lives.

5.4 Measures to increase the effectiveness and efficiency of public revenues and spending

In order to ensure the long-term sustainability of public finances and to fulfil the strategic objective of efficient fiscal policies, government revenue and spending are reviewed regularly to assess their effectiveness and efficiency. The primary aim is to **improve performance budgeting**, i.e. make public budgets more target- and results-driven. This makes it possible to take effective measures to modernise the German economy and to create additional fiscal space.

As a general trend, rising demography-related costs as well as increasing interest and repayment obligations are reducing disposable spending as a share of total expenditure. For this reason, it is important to set consistent priorities in line with the strategic focus of Germany's fiscal policy. Compliance with the regular borrowing limit under Germany's debt brake in the 2024 federal budget, and the associated effective budgetary restraints, will mean that spending will have to be reviewed more closely to improve performance budgeting, and clearer priorities will have to be set. In this way, the federal government is responding to the structural problems in the federal budget. It is also initiating the qualitative and quantitative consolidation of the federal budget that is required and moving forward with the normalisation of fiscal policy.

Since 2015, the federal government has been conducting subject-specific **spending reviews** which complement the top-down budget preparation process. Different subject areas are selected for review every year. In the spending reviews, existing revenue and spending categories are scrutinised to determine whether the associated targets are being achieved (effectiveness) and whether this is done economically (efficiency). The subject areas selected can include funding programmes, statutory benefits and cross-departmental tasks. Spending reviews increase transparency regarding the use of public funds, improve performance budgeting, and help to reprioritise spending and create fiscal space for new measures affecting public finances on both the revenue and expenditure side. So far, seven spending-review cycles focusing on ten different subject areas have been concluded.

The two most recent **spending-review cycles** focused on the **subject of sustainability**. In the 2021/2022 cycle, the Federal Ministry of Finance conducted the 10th spending review, which focused on the issue of "Embedding sustainable development goals in the federal budget", in cooperation with the Federal Ministry for the Environment, Nature Conservation, Nuclear Safety and Consumer

Protection and the Federal Ministry for Economic Cooperation and Development. The 11th spending review focused on the issue of "Improving performance budgeting in the federal budget, with a particular focus on sustainability". It was conducted in cooperation with the Federal Ministry for Economic Affairs and Climate Action and the Federal Ministry for the Environment, Nature Conservation, Nuclear Safety and Consumer Protection. The federal cabinet acknowledged the final report on 10 April 2024. As part of the 11th spending review, the process of embedding sustainable development goals in the federal budget was piloted in cooperation with the Federal Ministry for the Environment, Nature Conservation, Nuclear Safety and Consumer Protection and the Federal Ministry for Economic Cooperation and Development. In addition, specific measures for further improving performance budgeting in the federal budget were proposed in consultation with external experts.

The federal government coordinates its **subsidy policy** on the basis of its subsidy policy guidelines, which are aimed at enhancing transparency, accountability and governance. The federal government wants to eliminate subsidies and spending that are superfluous, ineffective or detrimental to the environment and the climate. Designing subsidies so they are temporary and degressive, and giving financial assistance precedence over tax benefits in the case of new subsidies, also serve this purpose. In addition, the federal government has committed to carrying out a sustainability impact assessment and a fundamental evaluation of subsidies.

When drawing up the government draft of the 2024 federal budget, the federal government once again reviewed all federal budget expenditures. Nevertheless, there was an increase in the subsidies contained in the 2024 federal budget due to projects that are receiving support within the framework of the Important Projects of Common European Interest (IPCEI) scheme, which are co-financed by EU funds. The federal government will continue its critical review of all subsidies in the coming years. The federal government reports on subsidies in its Subsidy Report, which is published every two years. The latest edition, the 29th Subsidy Report, was published on 30 August 2023. In line with the subsidy policy guidelines, the new subsidies introduced during the reporting period of the 29th Subsidy Report were largely granted in the form of temporary financial assistance.

Annex

Macroeconomic prospects[1]

Table 9

	ESA code	2023	2023	2024	2025	2026	2027	2028
		Index 2015=100	% change p.a.					
1. Real GDP, chain index	B1g	107.9	-0.3	0.2	1.0	0.7	0.7	0.7
2. Nominal GDP (€bn)	B1g	4,121.2	6.3	3.5	2.8	2.7	2.7	2.7
Components of real GDP, chain index								
3. Private consumption expenditure[2]	P.3	105.6	-0.7	1.1	1.0	0.7	0.7	0.7
4. Government consumption expenditure	P.3	117.6	-1.5	0.7	0.9	0.8	0.8	0.8
5. Gross fixed capital formation	P.51	108.5	-0.7	-0.7	1.7	0.8	0.8	0.8
6. Changes in inventories and net acquisition of valuables (GDP growth contribution)[3]	P.52 + P.53	-	0.0	-0.3	0.0	0.0	0.0	0.0
7. Exports	P.6	113.1	-2.2	0.6	3.4	2.6	2.6	2.6
8. Imports	P.7	121.6	-3.4	0.8	3.7	2.9	2.9	2.9
Contributions to real GDP growth[3]								
9. Final domestic demand		-	-0.9	0.6	1.2	0.8	0.8	0.9
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.0	-0.3	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	-	0.6	0.0	0.0	0.0	0.0	0.0

1 2023: Federal Statistical Office: as of February 2024
2024 and 2025: from the short-term forecast for the 2024 Annual Projection, February 2024
2026 to 2028: from the medium-term forecast for the 2024 Annual Projection, February 2024

2 Including private non-profit organisations serving households

3 Contribution to GDP growth rate

Price trends – deflators[1]

Table 10

	ESA code	2023	2023	2024	2025	2026	2027	2028
		Index (2015=100)	% change p.a.					
1. GDP		126.2	6.6	3.2	1.8	2.0	2.0	2.0
2. Private consumption[2]		123.5	6.3	2.8	1.8	2.0	2.0	2.0
3. Public consumption		126.8	6.0	4.7	2.2	2.6	2.6	2.6
4. Gross fixed capital formation		137.8	0.8	2.8	2.2	1.7	1.7	1.7
5. Exports		121.0	0.6	1.1	1.3	0.7	0.7	0.7
6. Imports		122.4	-3.4	0.9	1.7	0.7	0.7	0.7

1 2023: Federal Statistical Office: as of February 2024
2024 and 2025: from the short-term forecast for the 2024 Annual Projection, February 2024
2026 to 2028: from the medium-term forecast for the 2024 Annual Projection, February 2024

2 Including private non-profit organisations serving households

Labour market trends[1]

Table 11

	ESA code	2023	2023	2024	2025	2026	2027	2028
		Level	% change p.a.					
1. Employment, persons (domestic)[2] (m)		45.9	0.7	0.2	0.2	-0.2	-0.2	-0.2
2. Employment, hours worked[3] (bn hours)		61.7	0.4	1.0	0.2	-0.4	-0.4	-0.4
3. Unemployment rate[4] (%)		-	2.8	2.9	2.7	3.0	3.2	3.3
4. Labour productivity5 (2015=100)		101.3	-1.0	0.0	0.9	0.9	0.9	0.9
5. Labour productivity6 (2015=100)		105.7	-0.7	-0.7	0.8	1.2	1.1	1.2
6. Compensation of employees (€bn)	D.1	2,154.9	6.7	5.6	3.7	2.7	2.7	2.7
7. Compensation per employee (thousand €)		51.2	5.8	5.2	3.5	3.0	3.0	3.0

1 2023: Federal Statistical Office: as of February 2024
2024 and 2025: from the short-term forecast for the 2024 Annual Projection, February 2024
2026 to 2028: from the medium-term forecast for the 2024 Annual Projection, February 2024

2 Employed persons, domestic concept

3 National accounts definition

4 Unemployed (ILO) / labour force

5 Real GDP per person employed (domestic)

6 Real GDP per hour worked

Sectoral balances[1]

Table 12

	ESA code	2023	2024	2025	2026	2027	2028
		% of GDP					
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	6.0	6.6	6.3	6.2	6.1	6.0
of which:							
- Balance on goods and services		4.2	4.2	3.9	3.8	3.7	3.6
2. Net lending/borrowing of households	B.9	6.0	5.9	5.9	5.8	5.7	5.6
3. Net lending/borrowing of general government	EDP B.9	-2.5	-1¾	-1	-1¼	-1½	-1
4. Statistical discrepancy		-	-	-	-	-	-

1 2023: Federal Statistical Office: as of April 2024
2024 and 2025: from the short-term forecast for the 2024 Annual Projection, February 2024
2026 to 2028: from the medium-term forecast for the 2024 Annual Projection, February 2024

General government budgetary prospects

Table 13

	ESA code	2023	2023	2024	2025	2026	2027	2028
		€bn	% of GDP					
Net lending (EDP B.9) by subsector								
1. General government	S.13	-101.6	-2.5	-1¾	-1	-1¼	-1½	-1
2. Central government	S.1311	-93.2	-2.3	-1¼	-¾	-¾	-½	-½
3. State government	S.1312	-6.4	-0.2	-¼	-¼	-¼	-¼	0
4. Local government	S.1313	-12.1	-0.3	-¼	-¼	-¼	-¼	-¼
5. Social security funds	S.1314	10.0	0.2	0	0	-¼	-½	-¼
General government (S.13)								
6. Total revenue	TR	1,901.8	46.1	47	47½	48	48	48½
7. Total expenditure	TE[1]	2,003.4	48.6	48¾	48¾	49¼	49½	49½
8. Net lending/borrowing	B.9	-101.6	-2.5	-1¾	-1	-1¼	-1½	-1
9. Interest expenditure	D.41	36.1	0.9	1	1	1	1¼	1¼
10. Primary balance[2]		-65.5	-1.6	-1	-¼	-¼	-¼	¼
11. One-off and other temporary measures[3]		0.0	0.0	0	0	0	0	0
Selected components of revenue								
12. Total taxes (12=12a+12b+12c)		963.0	23.4	23¾	24	24½	24½	24¾
12a. Taxes on production and imports	D.2	424.0	10.3	10½	10¾	10¾	10¾	10¾
12b. Current taxes on income, wealth, etc.	D.5	529.7	12.9	13	13¼	13¼	13½	13¾
12c. Capital taxes	D.91	9.3	0.2	¼	¼	¼	¼	¼
13. Social contributions	D.61	709.6	17.2	17¾	18	18¼	18¼	18¾
14. Property income	D.4	30.0	0.7	½	½	½	½	½
15. Other[4]		199.1	4.8	5	4¾	4¾	4¾	4½

General government budgetary prospects

continuation Table 13

	ESA code	2023	2023	2024	2025	2026	2027	2028
		€bn	% of GDP					
Selected components of revenue								
16. = 6. Total revenue	TR	1,901.8	46.1	47	47½	48	48	48½
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]		1,672.6	40.6	41¼	42¼	42½	43	43½
Selected components of expenditure								
17. Compensation of employees + intermediate consumption	D.1+P.2	583.8	14.2	14½	14¼	14¼	14	14
17a. Compensation of employees	D.1	327.4	7.9	8¼	8¼	8¼	8¼	8¼
17b. Intermediate consumption	P.2	256.5	6.2	6¼	6¼	6	6	5¾
18. Social payments (18=18a+18b)		1,021.2	24.8	25¼	25½	26	26¼	26½
of which: unemployment benefits[6]		60.8	1.5	1½	1½	1½	1½	1¾
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	359.8	8.7	8¾	9	9¼	9¼	9½
18b. Social transfers other than in kind	D.62	661.4	16.0	16¼	16½	16¾	17	17
19. = 9. Interest expenditure	D.41	36.1	0.9	1	1	1	1¼	1¼
20. Subsidies	D.3	66.3	1.6	1	1	1	1	1
21. Gross fixed capital formation	P.51	109.8	2.7	2¾	3	3	3	2¾
22. Capital transfers	D. 9	96.8	2.3	2¼	2	1¾	1¾	1¾
23. Other[7]		89.4	2.2	2	2	2¼	2¼	2
24. = 7. Total expenditure	TE[1]	2,003.4	48.6	48¾	48¾	49¼	49½	49½
p.m.: Government consumption (nominal)	P.3	888.5	21.6	22	22	22	22¼	22¼

1 Adjusted by the net amount of payments in connection with swaps, so that TR – TE = B.9.

2 The primary balance corresponds to (B.9. line 8) plus (D.41. line 9).

3 A plus sign means deficit-reducing one-off measures.

4 P.11+P.12+P.131+D.39+D.7+D.9 (except D.91).

5 Including those collected by the EU and including an adjustment for uncollected taxes and social security contributions (D.995), if appropriate.

6 Includes cash benefits (D.621 and D.624) and in-kind benefits (D.631) related to unemployment benefits.

7 D.29+D4 (except D.41)+D.5+D.7+P.52+P.53+K.2+D.8.

Figures for the projection period are rounded to ¼.

No-policy change projections

Table 14

	2023	2023	2024	2025	2026	2027	2028
	€bn	% of GDP					
1. Total revenue at unchanged policies	1,901.8	46.1	47	47¾	48	48	48½
2. Total expenditure at unchanged policies	2,003.4	48.6	48¾	48¾	49¼	49½	49½

Figures for the projection period are rounded to ¼.

Amounts to be excluded from the expenditure benchmark

Table 15

	2023	2023	2024	2025	2026	2027	2028
	€bn	% of GDP					
1. Expenditure on EU programmes fully matched by EU funds revenue	9.5	0.2	¼	¼	¼	¼	¼
2. Cyclical unemployment benefit expenditure	0.5	0.0	0	0	0	0	0
3. Effect of discretionary revenue measures	-11.2	-0.3	¼	¼	¼	¼	¼
4. Revenue increases mandated by law	0.0	0.0	0	0	0	0	0

Figures for the projection period are rounded to ¼.

Discretionary measures at the general government level (including discretionary measures at the federal level)

Table 16

List of new measures*	Detailed description	ESVG code	Adoption status / entry into force	Budgetary impact (% of GDP)				
				2024	2025	2026	2027	2028
Enhancing security, defence and stability in partner countries[1] – here: changes compared with the 2024 government draft	Support for Ukraine in the form of military equipment, replacement of Bundeswehr materials that were provided to Ukraine, German contributions to the European Peace Facility (EPF), bilateral capacity-building projects	D.92	1 January 2024	-0.08				
Federal government package for future-proof finances, social security and investments in the future[2]	Abolition of the citizen's benefit bonus, expansion of the "job turbo" plan of action for labour market integration, reduction of expenditures of various ministries, increase of tax rates in aviation, gradual phasing-out of diesel subsidies, adjustment of basic income support for jobseekers	D.62, D.21, D.74	Different provisions enter into force on different dates	0.11	0.13	0.12	0.12	0.12
Federal government electricity price package for energy-intensive companies[3]	Cut in electricity duty for manufacturing companies to the lowest rate permitted by the European Union, continuation of supplementary aid (super cap) and expansion of electricity price compensation	D.21, D.31	Different provisions enter into force on different dates	-0.11	-0.11	-0.04	-0.04	-0.04
Creation of a capital stock to stabilise the rise of contributions in the statutory pension insurance system (pension reserve fund)[4]	Creation of a "generational capital fund" to bolster the statutory pension insurance system using capital market yields	F.51	With the implementation of the legislation for the generational capital fund	-0.28	-0.28	-0.28	-0.28	-0.28

* Compared with the Finance Ministry forecast of October 2023.

1 For details of the 2024 federal budget (in German), please see: https://www.bundesfinanzministerium.de/Web/DE/Themen/Oeffentliche_Finanzen/Bundeshaushalt/Bundeshaushalt-2024/bundeshaushalt-2024.html

2 For details (in German), please see: https://www.bundesfinanzministerium.de/Monatsberichte/2024/01/Inhalte/Kapitel-2a-Schlaglicht/schlaglicht-bundeshaushalt-2024.html

3 For details (in German), please see: https://www.bundesregierung.de/breg-de/aktuelles/strompreispaket-energieintensive-unternehmen-2235760

4 No effect on the deficit. For details (in German), please see: https://www.bundesfinanzministerium.de/Web/DE/Themen/Internationales_Finanzmarkt/Altersvorsorge/Generationenkapital/generationenkapital.html

General government debt developments (Maastricht debt ratio)

Table 17

	ESA code	2023	2024	2025	2026	2027	2028
		% of GDP					
1. Gross debt		63.6	64	63¼	63¼	63	62
2. Change in gross debt ratio		-2.4	¼	-¾	0	-¼	-1
Contributions to changes in the Maastricht debt ratio							
3. Primary balance		1.6	1	¼	¼	¼	-¼
4. Interest expenditure	D.41	0.9	1	1	1	1¼	1¼
5. Stock-flow adjustment		-4.9	-1½	-1¾	-1¼	-1¾	-2
p.m.: Implicit interest rate on debt[1]		1.4	1½	1½	1¾	2	2

1 Proxied by interest expenditure divided by the debt level of the previous year.

Figures for the projection period are rounded to ¼.

Cyclical developments

Table 18

	ESA code	2023	2024	2025	2026	2027	2028
		% of GDP					
1. Real GDP growth (%)		-0.3	0.2	1.0	0.7	0.7	0.7
2. Net lending of general government	B.9	-2.5	-1¾	-1	-1¼	-1½	-1½
3. Interest expenditure	D.41	0.9	1	1	1	1¼	1¼
4. One-off and other temporary measures[1]		0.0	0	0	0	0	0
5. Potential GDP growth (%)		0.7	0.6	0.5	0.5	0.5	0.5
contributions:							
- labour		0.3	0.2	0.0	-0.1	-0.2	-0.2
- capital		0.3	0.3	0.3	0.3	0.3	0.3
- total factor productivity		0.1	0.1	0.2	0.3	0.4	0.4
6. Output gap		-0.8	-1.2	-0.7	-0.5	-0.2	0
7. Cyclical budgetary component		-0.4	-½	-¼	-¼	0	0
8. Cyclically adjusted balance (2-7)		-2.0	-1¼	-¾	-1	-1¼	-1
9. Cyclically adjusted primary balance (8+3)		-1.2	-¼	¼	0	0	¼
10. Structural balance (8-4)		-2.0	-1¼	-¾	-1	-1¼	-1

1 A plus sign means deficit-reducing one-off measures.

Figures for the projection period are rounded to ¼.

Divergence from previous update

Table 19

	ESA code	2023	2024	2025	2026	2027
Real GDP growth (%)						
April 2023 projection		0.2	1.8	0.9	0.9	0.9
April 2024 projection		-0.3	0.2	1.0	0.7	0.7
Difference		-0.5	-1.5	0.2	-0.2	-0.2
General government net lending (% of GDP)	B.9					
April 2023 projection		-4¼	-1¾	-¾	-¾	-
April 2024 projection		-2.5	-1¾	-1	-1¼	-1½
Difference		1¾	-¼	-¼	-½	-
General government gross debt (% of GDP)						
April 2023 projection		67¾	66½	66¼	65½	-
April 2024 projection		63.6	64	63¼	63¼	63
Difference		-4	-2½	-2¾	-2	-

Figures for the projection period are rounded to ¼.

Long-term trends in age-related general government expenditure

Table 20

	2022 (actual)	2030	2040	2050	2060	2070
			Expenditure in % of GDP[1]			
			(pessimistic variant "T-" / optimistic variant "T+")			
Pension expenditure[2]	10.8	11.9/11.5	12.8/11.7	13.4/11.8	14.3/12.0	14.9/12.2
Healthcare expenditure[3]	7.0	7.1/7.0	7.7/7.2	8.1/7.1	8.4/7.1	8.7/7.2
Long-term care expenditure[4]	1.4	1.8/1.8	2.2/2.0	2.8/2.2	3.0/2.2	3.2/2.3
Unemployment benefits[5]	2.0	2.1/2.0	2.4/2.2	2.7/2.3	3.0/2.5	3.2/2.6
Spending on education and childcare[6]	4.4	4.6/4.7	4.6/4.9	4.4/4.9	4.6/4.9	4.6/4.9
Expenditure on the family benefits system[7]	1.6	1.4/1.5	1.4/1.5	1.4/1.5	1.5/1.5	1.5/1.5
Total age-related expenditure	27.3	29.0/28.4	31.2/29.3	32.9/29.8	34.7/30.2	36.1/30.8
Assumptions						
Productivity growth (%)[8, 9]	0.3	1.2/1.1	1.3/1.5	1.2/1.5	1.1/1.6	0.9/1.5
GDP growth (%)[9]	1.1	1.0/1.2	0.6/1.5	0.6/1.7	0.4/1.6	0.4/1.6
Labour force participation (%)						
- Men (15 to 64)	86.4	87.3/86.2	86.4/87.2	86.4/87.1	86.3/87.1	86.2/87.1
- Women (15 to 64)	81.6	84.3/83.4	83.2/84.0	83.3/84.0	83.6/84.2	83.6/84.2
Unemployment rate (%)[10]	3.1	3.7/3.6	4.5/3.9	5.0/4.1	5.6/4.3	6.0/4.5
Old-age dependency ratio (per 100)[11]	34.9	42.7/40.3	48.0/42.6	50.7/41.8	55.3/42.7	57.6/43.6
Total population (m)	84.0	83.6/86.9	81.6/88.5	79.1/89.5	76.1/90.7	73.5/92.7
Population aged 65+ (m)	18.7	21.5/21.2	23.1/22.5	23.3/22.5	23.7/23.1	23.6/24.0

Long-term trends in age-related general government expenditure

continuation Table 20

Sources: Actual figures for 2022: Federal Statistical Office, German Pension Insurance, Federal Ministry of Health, Federal Employment Agency, Federal Ministry of Labour and Social Affairs, Federal Ministry of Finance, Federal Ministry for Family Affairs, Senior Citizens, Women and Youth; projections (2030–2060): M. Werding et al. (2023), *Modellrechnungen für den Sechsten Tragfähigkeitsbericht des BMF* (Projections for the Federal Finance Ministry's Sixth Sustainability Report), 2024, updated for the base year 2022.

1 Cross-payments between sub-budgets have been consolidated.

2 Statutory pension insurance and civil servants' pensions

3 Statutory health insurance and medical assistance payments for civil servants and eligible relatives

4 Social long-term care insurance (applying the dynamic index used in the EU's 2018 Ageing Report)

5 Unemployment insurance, other Federal Employment Agency expenses and basic income support for jobseekers (including housing costs)

6 Public education spending (including childcare facilities) according to the definition used in the Education Finance Report

7 Child benefit, tax allowances for children under the Income Tax Act, parental benefit

8 Measured by labour productivity

9 Inflation-adjusted figures on productivity growth and GDP growth refer to changes compared with the previous ten-year period.

10 The number of people in employment and the number of unemployed people is determined on the basis of relevant national account strategies and therefore deviates from the microcensus data.

11 The old-age dependency ratio is based on the definition of a working-age population aged 15-64.

Impact of the Recovery and Resilience Facility (RRF) on the projection – grants

Table 21

	2020	2021	2022	2023	2024	2025	2026
Revenue from RRF grants (% of GDP)							
RRF grants as included in the revenue projections	0.00	0.18	0.10	0.07	0.13	0.10	0.07
Cash disbursements of RRF grants from EU	0.00	0.06	0.00	0.10	0.31	0.08	0.08
Expenditure financed by RRF grants (% of GDP)							
Total current expenditure	0.00	0.11	0.05	0.04	0.03	0.02	0.01
Gross fixed capital formation (P.51g)	0.01	0.00	0.00	0.00	0.00	0.00	0.00
Capital transfers (D.9)	0.00	0.05	0.05	0.03	0.10	0.08	0.06
Investment expenditure	0.02	0.05	0.05	0.03	0.10	0.08	0.06
Other costs financed by RRF grants (% of GDP)							
Tax revenue losses	0.00	0.00	0.00	0.00	0.00	0.01	0.01
Other revenue losses	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Financial transactions							

Any discrepancies are due to rounding.

Technical assumptions

Table 22

	2023	2024	2025	2026	2027	2028
Short-term interest rate (annual average)	3.88	4.13	3.19	3.00	3.00	3.00
Long-term interest rate (annual average)	2.4	2.3	2.2	2.2	2.2	2.2
USD/€ exchange rate (annual average)	1.08	1.09	1.09	1.09	1.09	1.09
Nominal effective exchange rate	110.6	108.3	108.8	108.8	108.8	108.8
World GDP growth rate (excluding EU)	3.5	3.4	3.4	3¼	3¼	3¼
EU GDP growth rate	0.6	1.2	2.0	1¾	1¾	1¾
Growth of German sales markets[1]	1.0	3.2	3.4	3¼	3¼	3¼
World imports growth rate (excluding EU)	1.2	3.2	3.4	3¼	3¼	3¼
Oil price (Brent, USD/barrel)	82	77	74	75	77	78

1 Values rounded to ¼

Contingent liabilities

Table 23

	2023
	% of GDP
Public guarantees	15.5*
Of which: linked to the financial sector	2.4

* Year 2022

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April 2024

Edited by
Division I A 1

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