Federal Ministry
of Finance

German Stability Programme

2014 Update

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Contents

Page

Preface to the German Stability Programme for 2014 7

1 Summary 8

2 Independent and reliable forecasts as a basis for realistic financial planning in Germany 9

2.1 Forecast of macroeconomic trends 9

2.2 Tax estimate 11

2.3 Role of the Stability Council 12

3 Macroeconomic environment in Germany 14

3.1 Macroeconomic situation in Germany in 2013 14

3.2 Short- and medium-term outlook for the overall economy, 2014-2018 15

4 German fiscal policy in the European context 18

4.1 Fiscal policy guidelines 18

4.2 Germany's voluntary fiscal policy commitments within the Euro Plus Pact 19

4.3 Implementation of the Fiscal Compact in Germany 20

5 Fiscal policy in Germany 22

5.1 Fiscal situation and strategic direction 22

5.2 Fiscal policy measures in terms of expenditure and revenue side 25

6 Projection of general government budget balance and debt level 29

6.1 Trends in general government revenue and expenditure 29

6.2 Trends in the general government fiscal balance 32

6.3 Trends in the general government structural balance 34

6.4 Sensitivity of projection of fiscal balance 35

6.5 Trends in debt levels 36

7 Long-term sustainability and quality of public finances 38

7.1 Challenges to the sustainability of public finances 38

7.2 Government revenue and expenditure from a long-term perspective 38

7.3 Measures to maintain long-term sustainability 40

7.4 Measures to increase the effectiveness and efficiency of public revenues and spending 42

Tables/Figures

Page

Table 1: Evaluation of the forecasts for real economic growth ... 11
Table 2: Trends in government revenue ratio ... 30
Table 3: Trends in the government expenditure ratio ... 32
Table 4: Trends in the general government balance ... 33
Table 5: Budget balances according to government level ... 34
Table 6: Structural balance compared with actual balance and GDP trend ... 35
Table 7: Sensitivity of projection of the general government budget balance ... 36
Table 8: Trends in the debt-to-GDP ratio ... 37
Table 9: Forecast of macroeconomic trends ... 44
Table 10: Price developments – deflators ... 45
Table 11: Labour market trends ... 46
Table 12: Sectoral balances ... 47
Table 13: General government budgetary prospects ... 48
Table 14: No-policy change projections ... 50
Table 15: Amounts to be excluded from the expenditure benchmark ... 50
Table 16: General government debt developments ... 50
Table 17: Cyclical developments ... 51
Table 18: Divergence from previous update ... 52
Table 19: Long-term trends in age-related general government expenditure ... 53
Table 20: Technical assumptions ... 54
Table 21: Contingent liabilities ... 54

Figures

Figure 1: Forecasting and planning of public budgets ... 13
Figure 2: Gross domestic product, adjusted for inflation ... 17
Figure 3: Actual and structual general government balance (in % of GDP) ... 23
Figure 4: Change in the Federation's structural deficit (in % of GDP) ... 24
Figure 5: Average annual trends in general government revenue/ expenditure and GDP trends from 2012 to 2017 ... 31
Figure 6: Effects on debt of stabilisation measures implemented in the context of the financial market crisis and the European sovereign debt crisis ... 37
Figure 7: Forecasts for age-related public spending until 2060 (in % of GDP) ... 40

Preface to the German Stability Programme for 2014

In accordance with the provisions of the preventive arm of the Stability and Growth Pact, every year eurozone member states draw up Stability Programmes while the remaining member states prepare Convergence Programmes. These reports are submitted in April to the European Commission and the Council of Economics and Finance Ministers (ECOFIN Council).

This update of the German Stability Programme was approved by the Federal Cabinet on 8 April 2014. The programme follows the "Guidelines on the format and content of Stability and Convergence Programmes" (Code of Conduct). The federal government submits each update of the German Stability Programme and the corresponding Council opinion on the updated German Stability Programme to the competent expert committees of the German Bundestag as well as to the Finance Minister Conference (the body that represents the finance ministers of the *Länder*) and the Stability Council. The Bundestag and Bundesrat had the opportunity to deliberate on both the Council Recommendation of 9 July 2013 regarding Germany's 2013 National Reform Programme as well as the Council opinion on Germany's Stability Programme for 2013-2017.

The Federal Ministry of Finance publishes the updated Stability Programme along with the programmes for preceding years online at:
http://www.bundesfinanzministerium.de

The programmes of all EU member states as well as the corresponding European Commission analyses and ECOFIN recommendations are published on the European Commission's website at:

http://ec.europa.eu/economy_finance/economic_governance/sgp/convergence/index_en.htm

1. Summary

Growth and employment can only be created in a stable and predictable environment that inspires confidence in the future. This cannot be achieved without sound finances. For this reason, Germany has placed its public finances on a solid foundation again. The trend of rising indebtedness has been interrupted. The first important step towards making Germany's consolidation achievements permanent has been taken, by balancing the national budget for two years in a row.

In 2012, the general government surplus was equivalent to 0.1% of gross domestic product (GDP). In 2013, it was possible to balance the budget again, despite the weak economic phase at the start of the year. In structural terms, too, the situation is very positive. Germany's general government structural deficit is well below the upper limit stipulated as the medium-term objective, namely 0.5% of GDP.

One of the federal government's main goals is to secure what has already been achieved during the consolidation process. It has set itself the targets of eliminating new borrowing and achieving a lasting reduction of its debt ratio. On 12 March 2014, the federal government adopted the government draft of the 2014 federal budget, which is structurally balanced. On the same day, it also approved the key figures for the years beginning in 2015, which envisage budgets that do not require any new borrowing at all. The Federation is therefore making a significant contribution to a permanently balanced general government budget, which will be achieved according to the budgetary forecast presented in this Stability Programme.

Germany wants to reduce its debt level significantly faster than is stipulated in the European rules. The federal government's goal is to reduce the debt ratio to less than 60% of GDP within 10 years, with the intermediate target of bringing it under 70% by the end of 2017.

Germany's 2014 National Reform Programme, which is prepared in tandem with the Stability Programme, depicts the progress that Germany has made under the Europe 2020 growth strategy, the implementation of the country-specific recommendations for 2013 and the Action Programme 2013 for the Euro Plus Pact. Those measures in the National Reform Programme that have a fiscal impact also form part of the Stability Programme's fiscal strategy and public budget projection.

2. Independent and reliable forecasts as a basis for realistic financial planning in Germany

2.1 Forecast of macroeconomic trends

Each year, the federal government presents three macroeconomic forecasts. The annual projection is published in January of each year as part of the Annual Economic Report. In addition, the spring forecast is produced every April and the autumn forecast in October. Each projection includes a forecast for the short term (the current year and the following year) and a medium-term forecast for the three years after that, which is based on the short-term forecast. The medium-term forecast is prepared under the assumption that normal economic conditions will be achieved in the final year of the forecast period – in other words, it assumes that the output gap, which measures the extent to which the economy's expected performance deviates from normal conditions, is equal to zero.

The federal government's spring and autumn forecasts are produced by the Interdepartmental Macroeconomic Forecasting Group under the direction of the Federal Ministry for Economic Affairs and Energy. This panel of experts includes specialists from the federal ministries and representatives of the Deutsche Bundesbank, the Institute for Employment Research (*Institut für Arbeitsmarkt- und Berufsforschung*) and the Federal Statistical Office. The macroeconomic forecasts are prepared within the consistent framework of the system of national accounts. The forecasts are therefore mainly based on the current national accounts data from the Federal Statistical Office at the time of the forecast, as well as supplementary indicators regarding the economic situation and expectations that are available. Another important basis is forecasts by international organisations on global economic trends. The federal government's forecasts are compared with the current forecasts by the European Commission and other independent institutions, including economic research institutes, the International Monetary Fund, the OECD and the Deutsche Bundesbank. As part of this, any discrepancies between the forecasts are identified and their causes analysed.

The federal government uses the Joint Economic Forecast, which is prepared by leading economic research institutes, as a reference for its own spring and autumn forecasts. The research institutes independently prepare a report with their assessment of macroeconomic trends. This is always published shortly before the federal government's projection. The right to participate in the Joint Economic Forecast is allocated for a period of three years following a public tender procedure. Currently, the following economic research institutes are involved: the ifo Institute for Economic

Research in Munich, the Halle Institute for Economic Research, the German Institute for Economic Research in Berlin, the Austrian Institute of Economic Research in Vienna, the KOF Swiss Economic Institute at ETH Zurich, Kiel Economics, the Essen-based RWI (Rheinisch-Westfälisches Institut für Wirtschaftsforschung) and the Institute for Advanced Studies in Vienna.

An Annual Economic Report describing the current economic situation and its foreseeable development is published by the independent Council of Economic Experts (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung), which was established by law in 1963 (through the Act on the Appointment of a Council of Experts on Economic Development). The report presents and appraises scenarios based on a range of assumptions and their impacts. It also addresses undesirable developments and options for averting or remedying them. The Council of Economic Experts submits the report, complete with macroeconomic forecasts, to the federal government by 15 November each year.

In accordance with section 6 of the above-mentioned law, the federal government submits the Annual Economic Report to the German legislative bodies in January of each year. In the report, the federal government presents its conclusions derived from the Council of Economic Experts' report, lays out its economic and financial goals for the current year in accordance with section 2 of the Act to Promote Economic Stability and Growth and presents its annual forecast for macroeconomic trends. The following year's Annual Economic Report compares and evaluates the previous year's annual forecast against the first provisional estimate of annual GDP, which is published by the Federal Statistical Office at the start of January.

Detailed macroeconomic and budgetary projections are published in monthly reports by the Federal Ministry for Economic Affairs and Energy and the Federal Ministry of Finance, which are also available on their websites. The Federal Ministry for Economic Affairs and Energy presents the federal government's projections to the public and discusses the forecasts. The fact that external forecasts are taken into account, as well as the high level of transparency, guarantees that the government's macroeconomic projections are of high quality. The following table demonstrates the quality of the projections for the last three years. However, the economic shocks during the crisis of 2008–2009 could not be foreseen in the federal government's projections. Neither were they predicted in the forecasts of German or international institutes and organisations.

Table 1: Evaluation of the forecasts for real economic growth

	Autumn forecast (October of the previous year)	**Annual forecast** (January of the year in question)	**Spring forecast** (April of the year in question)	**GDP growth** (preliminary results from the Federal Statistical Office in February of the following year)
2009	0.2	-2.3	-6.0	-5.0
2010	1.2	1.4	1.4	3.6
2011	1.8	2.3	2.6	3.0
2012	1.0	0.7	0.7	0.7
2013	1.0	0.4	0.5	0.4

2.2 Tax estimate

Based on the spring and autumn macroeconomic forecasts, the Working Party on Tax Revenue Estimates calculates the anticipated tax revenue for the Federation, *Länder* and local authorities. The tax estimate provides the basis for the federal budget as well as for medium-term financial planning.

The Working Party on Tax Revenue Estimates, which has existed since 1955, is an independent advisory council based at the Federal Ministry of Finance. The council includes representatives from the Federal Ministry of Finance (which coordinates the work of the council), the Federal Ministry for Economic Affairs and Energy, five economic research institutes, the Federal Statistical Office, the Deutsche Bundesbank, the German Council of Economic Experts, the finance ministries of the *Länder* and the Federation of German Local Authority Associations. The composition of the body ensures that it remains independent. The representatives sent by the institutions belong to the working level.

The members of the Working Party on Tax Revenue Forecasting are not required to use a particular set of tools when making their predictions. Those members who produce their own proposed estimates prepare them using their own methods and models. New methodological approaches are developed at methodology sessions. In preparation for the work of the Working Party, eight of its members, namely the representatives of the economic research institutes, the Bundesbank, the Council of Economic Experts and the Federal Ministry of Finance, produce their own proposed estimates for each type of tax independently of each other. These proposed estimates are then discussed within the Working Party. The Working Party considers the estimates for each tax until a consensus has been found that all members support (consensus

principle). Based on the estimates for the individual taxes, the revenue expected to accrue to the Federation, the *Länder*, the local authorities and the EU is calculated.

The results are generally announced by the federal finance minister at a press conference immediately after the meeting. The tables of results are published on the Federal Ministry of Finance's website, thereby making them accessible to the public.

The meetings of the Working Party on Tax Revenue Estimates are geared to the schedules for budgetary and financial planning. There are two meetings a year.

- At the start of November, a tax revenue forecast is made for the medium-term (the current year and the following five years). This estimate provides the final figures for expected tax receipts that will be entered into the following year's budget. The forecast is also used as a basis for starting work on the budget for the year after next and the financial plan.

- In mid-May, a second medium-term tax revenue estimate is conducted (for the current year and the following four years). Its results form the basis for the draft budget of the following year and for the annual updating of the medium-term financial planning.

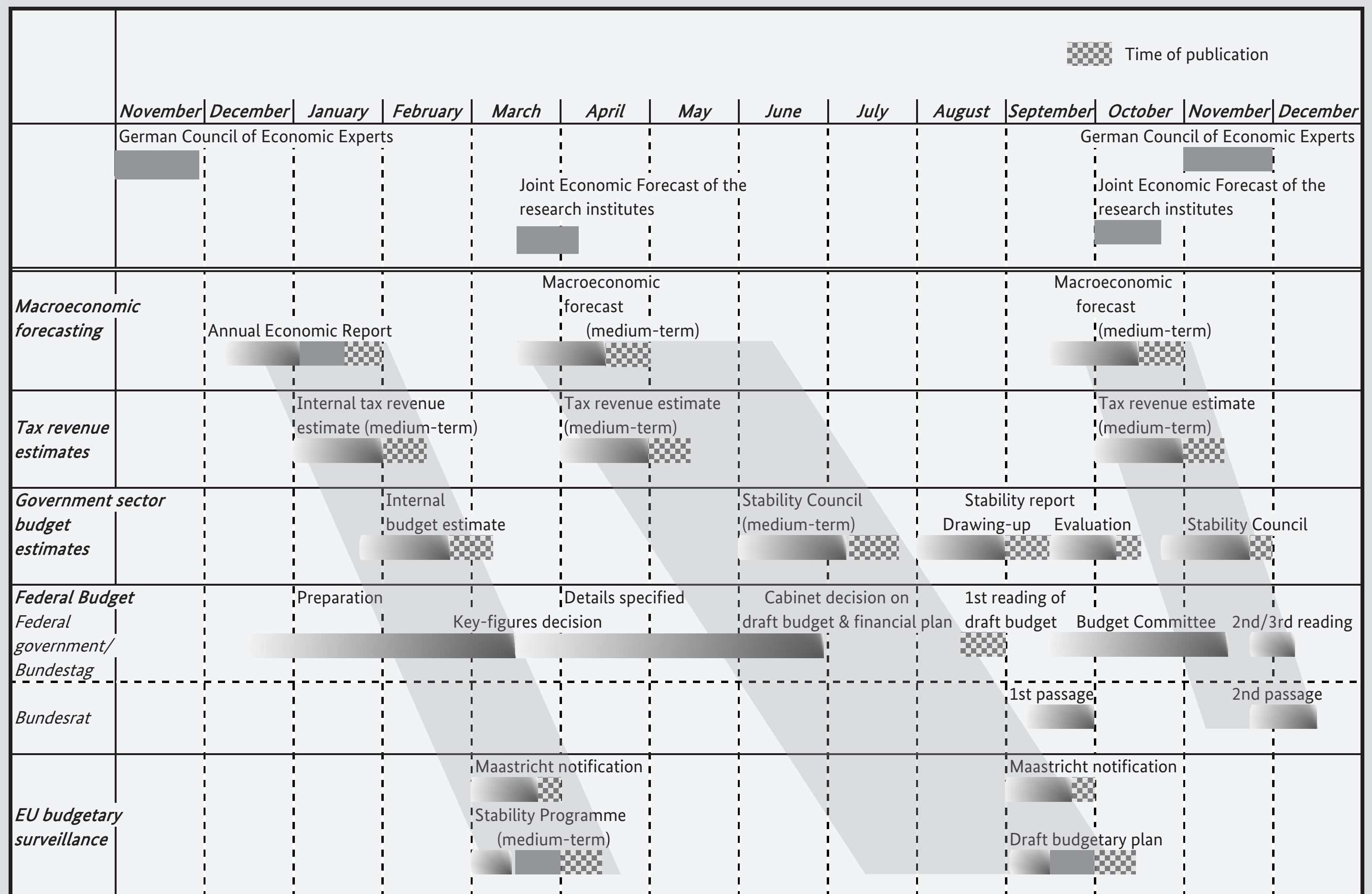
2.3 Role of the Stability Council

The Stability Council considers the overall economic and fiscal conditions in existence at the time that the federal, *Länder* and local government budget and financial plans are drafted. The aim is to coordinate budgetary and financial planning among the different levels of government. In the process, due regard must be given to the Federal Republic of Germany's obligations to observe budgetary discipline that result from legal instruments of the European Union on the basis of Articles 121, 126 and 136 of the Treaty on the Functioning of the European Union and, within this framework, to the requirements of overall economic equilibrium. The Stability Council may issue recommendations for the purposes of coordinating budgetary and financial planning. This ensures that the Stability Council's monitoring of the federal and *Länder* budgets is embedded into the overall economic and fiscal context. This also includes compliance with the Maastricht criteria and the need to react to cyclical fluctuations.

As part of the implementation of the Fiscal Compact in Germany (see also Chapter 4.3 "Implementation of the Fiscal Compact in Germany"), the Stability Council was also charged with monitoring compliance with the upper limit on the general government structural deficit twice a year, on the basis of an estimate of the general government balance. In addition, the projections of the general government budget presented by the Federal Ministry of Finance are also discussed in the Stability Council Working Group, as are the expected fiscal trends for the *Länder* budgets. An independent advisory board was set up to support the Stability Council in monitoring compliance with the upper limit on the general government structural deficit.

Budget planning in Germany is based on forecasts of macroeconomic trends that are monitored and critically examined by independent institutions as well as being discussed with all relevant stakeholders (see Chapter 2.1). The estimate of tax revenues, which is based on these projections, is carried out independently (see Chapter 2.2). This guarantees that the forecasts are reliable and of high quality and provide an important basis for realistic financial planning in Germany. Figure 1 shows how the various elements of macroeconomic forecasts, tax estimates, estimates and monitoring of the general government budget, preparation of the federal budget and monitoring of budgets by the EU relate to each other chronologically.

Figure 1: Forecasting and planning of public budgets



3. Macroeconomic environment in Germany

3.1 Macroeconomic situation in Germany in 2013

After a phase of weak growth in the first quarter of the previous year, the German economy found itself on a robust recovery course. Germany's real GDP grew moderately in 2013, by 0.4%. The weak performance of the economy in the final quarter of 2012 and the first quarter of 2013, which was caused by the unfavourable weather conditions, had a negative impact on average economic growth for 2013. The economy recovered over the further course of the year, a trend which continued for the rest of the year. The economy was significantly more dynamic in 2013 than in 2012, which is reflected in the year-on-year growth figures in the final quarter of each year (1.4% in 2013 compared with 0.3% in 2012). On average in 2013, domestic demand was the main pillar of economic growth in purely arithmetic terms. Domestic consumption contributed 0.4 percentage points to the increase in GDP. The expansion of domestic demand in 2013 propelled an increase in imports, which were up by 0.9%, while exports saw a slightly smaller increase (0.8%). The challenging international economic environment at the end of 2012 and the beginning of 2013 impacted negatively on exports. As a result, net exports made no contribution to economic growth in purely arithmetical terms.

While consumer spending rose by 0.9% in real terms, price-adjusted investment in equipment fell by 2.4% in 2013 compared with the previous year. Although investment saw a positive turnaround in the second quarter, it could not make up for the decline over the previous one-and-a-half years. Construction investment increased by 0.1% in 2013 compared with 2012. In both sectors, an expansion of public investment activities had a positive impact, while non-government investment – with the exception of residential construction – posted a decline. The labour market showed itself to be robust in 2013 on average. This can be seen mainly in the clear rise in employment, which rose by 0.6% to 41.84 million (using the domestic concept). Nevertheless, the rate of employment growth almost halved in comparison with 2012. However, a levelling-off of the growth rate was predictable, given the high employment level that had already been reached. Despite the growth in

employment, there was also a slight increase in the number of people out of work, which grew to 2.95 million (53,000 higher than in the previous year). The unemployment rate posted a marginal increase of 0.1 percentage points, reaching 6.9%. The average increase in the consumer price index during 2013 was 1.5%, tangibly lower than in 2012 (2.0%). In particular, a decline in prices for heating oil and fuels, and the elimination of the mandatory quarterly medical consultation fee, had a moderating effect on inflation. However, 2013 also saw a rise in electricity prices, as a result of an increase in the levy charged on electricity consumers to promote renewable energy sources, and a noticeable climb in food prices.

3.2 Short- and medium-term outlook for the overall economy, 2014-2018

The leading indicators suggest that the outlook for 2014 is positive. In particular, sentiment among companies and consumers has repeatedly improved. Taken together, the economic data and the improving global economic situation suggest that the economic recovery will lead to a broad-based economic upturn in 2014. In its annual projection for 2014, the federal government expects real GDP to grow by 1.8%. Year-on-year growth of 2% in the final quarter of 2013 suggests that the economic growth rate will be noticeably higher this year than it was in 2013. As a result of the upswing, overall economic growth in 2014 is expected to considerably outstrip the expansion of the German economy's potential output. However, the production capabilities of the economy as a whole are high enough to allow an upswing without inflationary pressures.

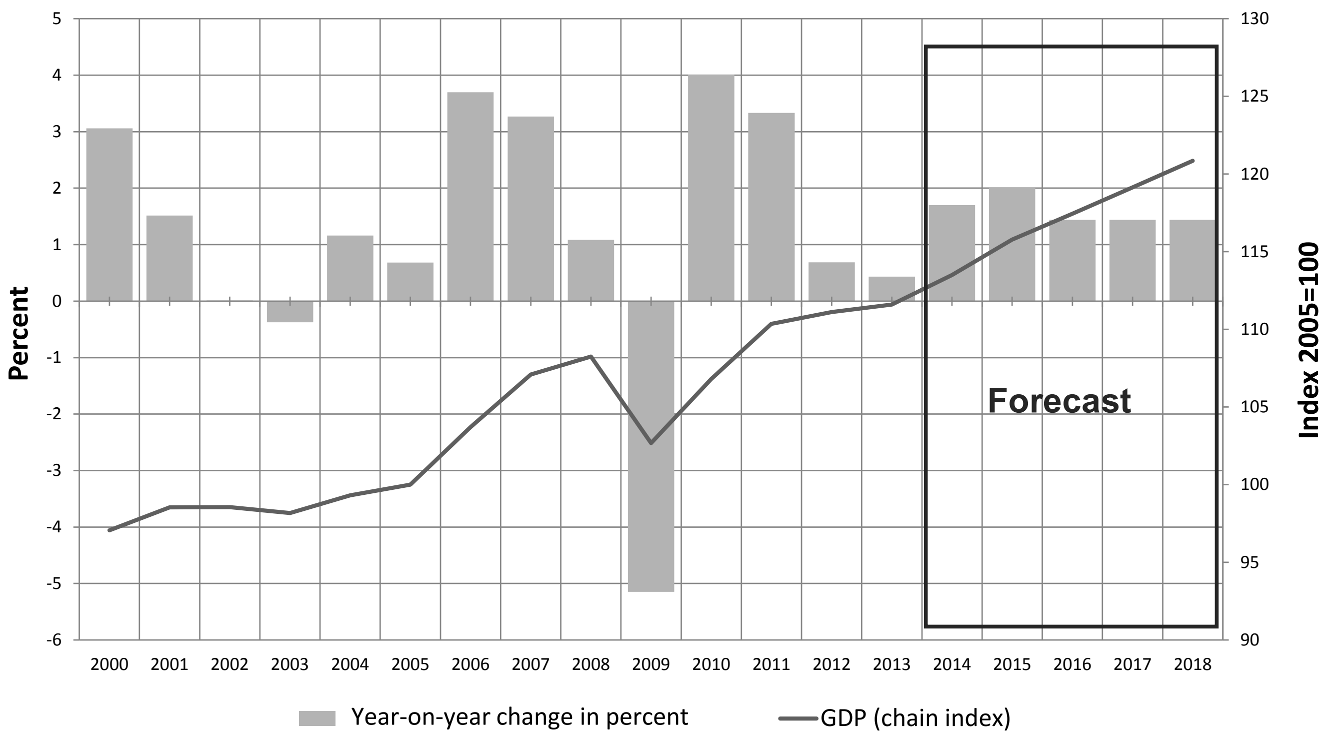
In 2014, economic growth will once again be propelled by domestic demand in arithmetic terms. Private consumption is projected to increase by 1.4%, which will once again make it a key driver of growth, just as in 2013. This development will be the result of a further rise in employment as well as positive income trends. Gross wages and salaries per employee are expected to expand by 2.7% (compared with 2.2% in 2013). Total gross wages and salaries will increase by 3.3%, in connection with a noticeable rise in employment. Net wages and salaries will increase at a somewhat slower rate. This, together with the expansion of monetary social security benefits and greater income from self-employment and property, means that households' disposable income is likely to increase by 2.9%. In conjunction with the moderate rate of inflation, this will boost consumers' purchasing power. Government consumption is also likely to drive growth this year.

The upwards trend in plant and equipment investment that started in the spring of 2013 will pick up pace in 2014 (+4.0% in real terms). This is based on the brightening situation in the world economy and the related favourable sales outlook as well as on strong prospects for corporate profits and good financing opportunities for businesses. However, capacity utilisation levels in the manufacturing sector remain marginally below their long-term average. As a result, business expansion will only gradually start playing a more important role, a view supported by the most recent survey of the Association of German Chambers of Commerce and Industry (DIHK). Construction investment will also rise this year, by 3.2%. Residential construction will provide a boost in this respect. It is likely to accelerate, given increases in household income and low interest rates. Commercial construction is expected to recover. Public investment, too, is likely to provide significant positive impetus to growth.

International organisations expect the global economy to grow at a slightly faster pace in 2014 than it did in 2013. This will benefit exports by German businesses. At the same time, the rise in export activity and increased investment in plant and equipment will also contribute significantly to an expansion of imports, due to the high import content of German exports. As a result, imports will register higher gains (5%, in real terms) than exports (4.1%). In arithmetic terms, the contribution of net exports to growth is forecast to be near zero. The labour market will contribute to develop robustly. A further reduction in unemployment (-20,000) is expected this year. Given the increase in the economy's momentum, labour demand will remain high. Employment is likely to rise by 0.6% (240,000) to 42.1 million (according to the domestic concept). This trend is supported by high immigration and increasing levels of labour force participation among older people and women. Just as in 2013, the increase in the consumer price index will be moderate in 2014 (1.5% over the previous year). Core inflation (the rise in consumer prices excluding the prices of food and energy) is expected to reach 1.6% in 2014, slightly above its 10-year average of 1.2%.

Due to the fact that growth in 2013 was only moderate, there is sufficient spare capacity to ensure that the upturn will be smooth. The negative output gap had clearly increased compared with 2012. Given the positive growth projections, the underutilisation of capacity in the economy as a whole will be partly reduced in 2014. For 2015, the federal government expects the economy to achieve strong growth once again, with a 2.0% increase in real GDP. The medium-term forecast for the 2016-2018 period predicts average real growth of around 1½% per annum. The positive trend on the labour market will continue over this period. By 2018, the number of people in work will have increased to around 42.4 million. The potential growth rate during the 2016-2018 period is estimated to be around 1¼% per annum. The forecast is based on the assumption that the negative output gap will have gradually closed by the end of the medium-term forecast period, implying that overall capacity utilisation will return to normal in 2018.

Figure 2: Gross domestic product, in real terms



4. German fiscal policy in the European context

4.1 Fiscal policy guidelines

The European Semester brings together various processes of economic and fiscal policy coordination in the EU. The term "semester" refers to the fact that member states' budgetary and economic policies are coordinated and reviewed at European level during the first half of each year. Member states then implement the corresponding requirements and agreements regarding their budget planning and structural reforms. Each year's European Semester is launched by the Commission's Annual Growth Survey, which is published at the end of the preceding year. The Semester concludes in summer with the ECOFIN Council's country-specific recommendations to the member states. These recommendations are proposed by the Commission and are based on an assessment of the National Reform Programmes and Stability/Convergence Programmes of the member states.

In the area of fiscal policy, the ECOFIN Council recommended in July 2013 that Germany should take action during the 2013-2014 period to: "Preserve a sound fiscal position, as envisaged, which ensures compliance with the MTO over the Programme horizon. Pursue a growth-friendly fiscal policy through additional efforts to enhance the cost-effectiveness of public spending on healthcare and long-term care through better integration of care delivery and a stronger focus on prevention and rehabilitation and independent living." In addition, the ECOFIN Council urged Germany to "use the available scope for increased and more efficient growth-enhancing spending on education and research at all levels of government" and to "complete the implementation of the debt brake in a consistent manner across all *Länder*, ensuring that monitoring procedures and correction mechanisms are timely and relevant." In a more detailed analysis published in March 2014 as part of the Macroeconomic Imbalance Procedure, the Commission advised Germany to increase public investment, among other things.

On the basis of the Commission's current Annual Growth Survey, the ECOFIN Council in February 2014 confirmed that "pursuing differentiated growth-friendly fiscal consolidation and ensuring long-term sustainability of public finances" are priorities for the EU and its member states. The Council welcomed the considerable progress made

with fiscal consolidation. Aggregate debt levels in the EU and euro area are expected to start decreasing in 2015. At the same time, the Council emphasised that member states are obliged to comply with the rules of the Stability and Growth Pact and to anchor fiscal policies in effective national governance frameworks to enhance confidence. In addition, the Council stressed that more attention should be paid to the quality and composition of fiscal adjustment as well as to the influence of fiscal policy on growth. This includes ensuring an appropriate mix of revenue and expenditure measures, reducing the taxation of labour, the modernisation of public administrations and giving priority to public spending aimed at increasing the growth potential. In its summit conclusions of 21 March 2014, the European Council of the heads of state and government also reaffirmed that differentiated, growth-friendly fiscal consolidation is a priority for the EU and its member states.

Chapters 4.3 and 5 below and Germany's 2014 National Reform Programme will address these recommendations by the Commission and Council. Comments on the Commission's tax-policy recommendations can also be found in the 2014 National Reform Programme.

4.2 Germany's voluntary fiscal policy commitments within the Euro Plus Pact

Within the framework of the Euro Plus Pact, Germany committed itself last year to preparing the 2014 federal budget without a structural deficit. It also pledged to take steps to ensure that the cumulative balance that has accumulated in the debt-brake control account by the time the transitional arrangements expire at the end of 2015 cannot be offset by negative account entries in the future. A positive balance has accumulated in the control account over the last three years because the deficit has been below the debt brake's limit that applies during the transitional period.

In the draft federal budget for 2014 that the cabinet adopted on 12 March, the federal government presented a structurally balanced budget. Not only is the structural deficit below the debt brake's upper limit of 0.35% of GDP (which actually only applies from 2016 onwards) for the third year in a row, but the Federation has achieved its best budgetary situation in decades. In addition, legislation on the domestic implementation of the Fiscal Compact, which came into force on 19 July 2013, stipulates that the control account's cumulative balance will be reset to zero at the end of the transitional period, on 31 December 2015. As a result, the full impact of the control account will be attained as of 1 January 2016. This will also ensure that the cumulative positive entries from the transitional period are not permanently transferred to the debt-brake system.

Moreover, the federal government committed itself in 2013, as part of the Euro Plus Pact, to further improve the stability of the financial markets. These commitments include simplifying the procedures for winding up and restructuring credit institutions, creating provisions to ensure that high-risk activities are separated from deposit-taking activities, and introducing clear criminal liability rules for bank and insurance company executives who violate their obligations.

The federal government fulfilled these self-commitments in 2013 when it introduced the Act on Protection against Risks and on Planning the Reorganisation and Liquidation of Credit Institutions. This legislation was adopted in the summer of 2013 as a further element in the new regulatory framework for the financial markets. It includes the following points: First, credit institutions and supervisors are required to submit reorganisation and resolution

plans. Second, particularly high-risk activities must be separated from deposit-taking activities by the middle of 2016. Third, criminal-law options for punishing breach of duty by senior managers in the area of risk management have been enhanced and made more specific.

On 8 April 2014, Germany adopted its Action Programme 2014 for the Euro Plus Pact. The federal government is continuing with its successful consolidation strategy while also making it more focused on growth. The Federation is planning its revenue and spending in such a way as to ensure that, as of 2015, the federal budget will not require any net new borrowing. Modern, efficient and well-developed infrastructure is an important precondition if a country is to be competitive internationally. Therefore, the federal government will increase investment in transport infrastructure by a total of €5 billion during this legislative period and will, as a first step, make €505 million available for this purpose in 2014. This will help to increase the profitability of private investment and overall economic productivity, thereby boosting growth and employment. These and other commitments contained in the German Action Programme for the Euro Plus Pact are described in the 2014 National Reform Programme.

4.3 Implementation of the Fiscal Compact in Germany

With the Fiscal Compact, the participating eurozone member states, as well as those non-euro countries that have issued a corresponding declaration, have committed themselves to introducing debt brakes. The Fiscal Compact stipulates that debt brakes must be transposed into national law through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes. The deadline for doing so was 1 January 2014. Among other things, the Fiscal Compact stipulates that national provisions must ensure that the annual general government structural balance corresponds to the country-specific medium-term objective, as defined in the revised Stability and Growth Pact, with an upper limit of a structural deficit of 0.5% of nominal GDP, for as long as the debt ratio is not significantly below 60% of GDP. Significant deviations from the medium-term objective, or from the adjustment path that aims to reach this objective, should automatically trigger a correction mechanism. Independent institutions on the national level should monitor compliance with the fiscal rules that ensure the requirements of the Stability and Growth Pact are achieved and complied with.

The debt brakes for the Federation and *Länder* that were enshrined in the Basic Law in 2009, together with the existing fiscal rules for the social security funds and local authorities, are aimed at ensuring compliance with Germany's medium-term objective under the preventative arm of the Stability and Growth Pact. The existing rules were extended with the Fiscal Compact Implementation Act, which came into force on 19 July 2013. This legislation implemented the permissible upper limit on the general government structural deficit of 0.5% of

nominal GDP. It also amended the Budgetary Principles Act to include a reference to Article 3 of the Fiscal Compact and Council Regulation (EC) No 1466/97, most recently amended by Regulation (EU) No 1175/2011, for details on the demarcation, calculation and permissible deviations from the upper limit, as well as the scope and time frame for reducing the general government structural deficit in the event of a deviation.

The Stability Council was charged with monitoring compliance with the upper limit on the general government structural deficit under the Budgetary Principles Act. If, following its review, the Stability Council concludes that the upper limit for the general government structural deficit has been or will be exceeded, it recommends suitable measures for eliminating the excessive deficit. The Stability Council is supported in its monitoring function by an independent advisory board. The advisory board's members comprise one representative each from the Deutsche Bundesbank, the German Council of Economic Experts and the institutes involved in preparing the Joint Economic Forecast. The board's members also include two independent experts appointed by the Federation, two experts appointed by the *Länder*, one independent expert representing the local authorities and one independent expert representing the national organisations of the social security funds. The advisory board met for the first time on 5 December 2013.

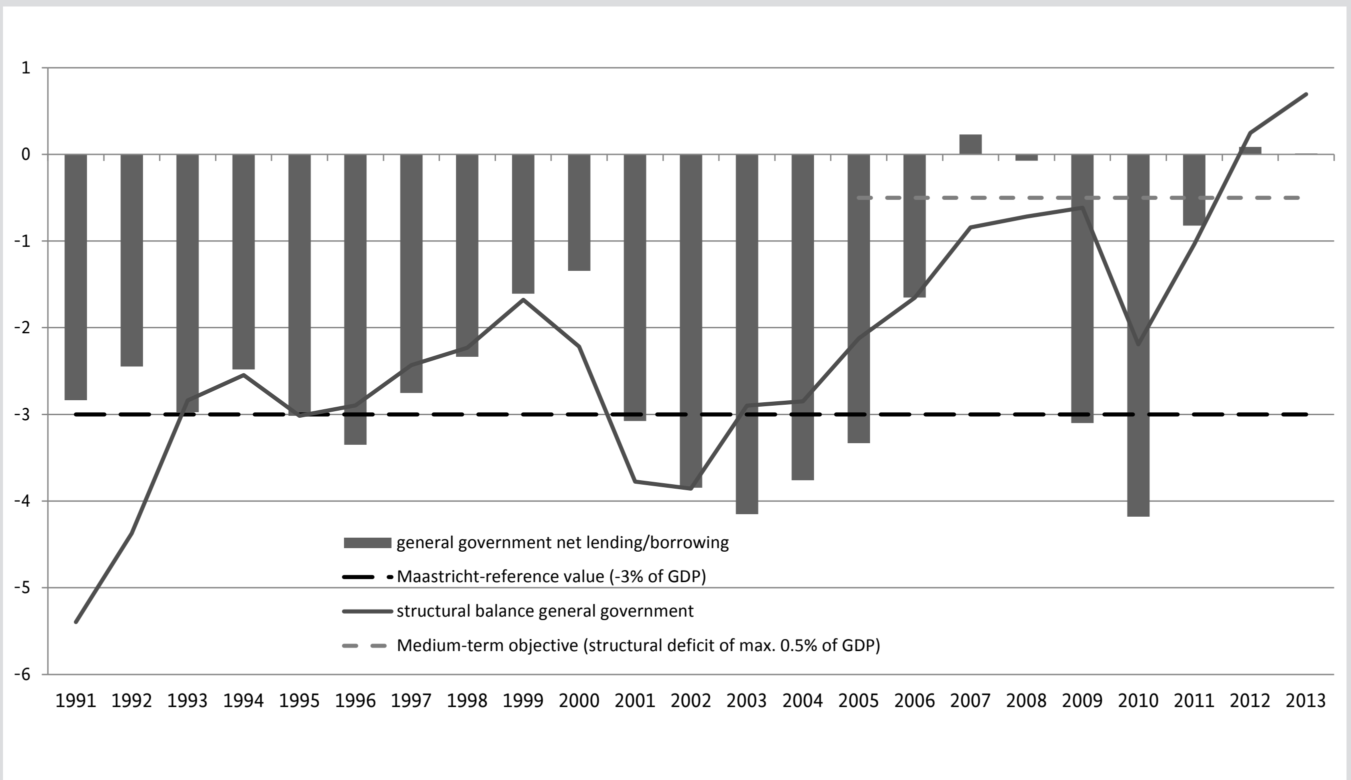
Debt-brake rules stipulate that, if the target is missed in one fiscal year, an immediate return to a structurally balanced budget is necessary the following year. In the case of the Federation, additional consolidation obligations can arise as a result of the control account. Hence the German debt-brake system represents a very stringent form of the correction mechanism that is required in accordance with Fiscal Compact rules. The Stability Council's recommendations, in conjunction with the debt-brake rules of the Federation and the *Länder* and the fiscal rules of the local authorities and social security funds, constitute an additional fiscal correction mechanism for the general government. This also complies with the country-specific recommendation that Germany should ensure "that monitoring procedures and correction mechanisms are timely and relevant". Regarding the implementation of the debt brake in all the *Länder*, it should be noted that the rule enshrined in the Basic Law also applies directly to the *Länder*. Under the debt-brake rule, the *Länder* may not incur any new debt as of 2020. If a Land does not adopt further provisions regarding adjustment for cyclical factors or regarding exceptional situations, then a prohibition on new borrowing with no exceptions will apply starting in 2020.

5. Fiscal policy in Germany

5.1 Fiscal situation and strategic direction

In recent years, Germany has placed its public finances on a solid foundation. Following a clear increase in the budget deficit in the wake of efforts to tackle the financial and economic crisis, Germany has taken the first important step towards making its consolidation successes permanent by balancing its budget for two years in a row. The general government fiscal deficit, which was 4.2% of GDP in 2010, was eliminated in just two years. In 2012, Germany had a surplus of 0.1% of GDP. In 2013, Germany was once again able to achieve a balanced budget despite the weak economic phase at the start of the year. From a structural perspective, the fiscal position has improved further. Following a small surplus totalling 0.3% of GDP in 2012, there was a general government structural surplus again in 2013 (0.7% of GDP). As a result, Germany has managed to maintain its sound budgetary situation, as recommended by the ECOFIN Council, and to lay the foundations for compliance with the structural medium-term objective over the whole programme period.

Figure 3: Actual and structural general government balance (in % of GDP)



1995: Excluding asset transfers resulting from the assumption of debts of the Treuhand privatisation agency and German Democratic Republic housing companies. When this effect is included, the general government deficit amounted to 9.5% of GDP.
2000: Excluding UMTS proceeds. When this effect is included, the general government budget ran a surplus of 1.1% of GDP.

In contrast to the actual balance, the structural balance is not based on the current economic situation but on normal economic conditions, known as potential output. Potential output is a measure of production capacity in the whole economy, which determines an economy's prospects for growth in the medium and long term. Hence the structural balance represents the financial situation based on the fundamental underlying structures, excluding cyclical influences and one-off effects.

With its results for the actual and structural financial balance, Germany has clearly complied with the European requirements in 2013 as well. Germany's fiscal balance, which is 0.0% of GDP, lies far below the Maastricht reference value, which stipulates that the deficit cannot exceed 3.0% of GDP. The medium-term objective of a general government fiscal deficit of 0.5% of GDP was also easily complied with, given that Germany has a structural surplus of 0.7% of GDP.

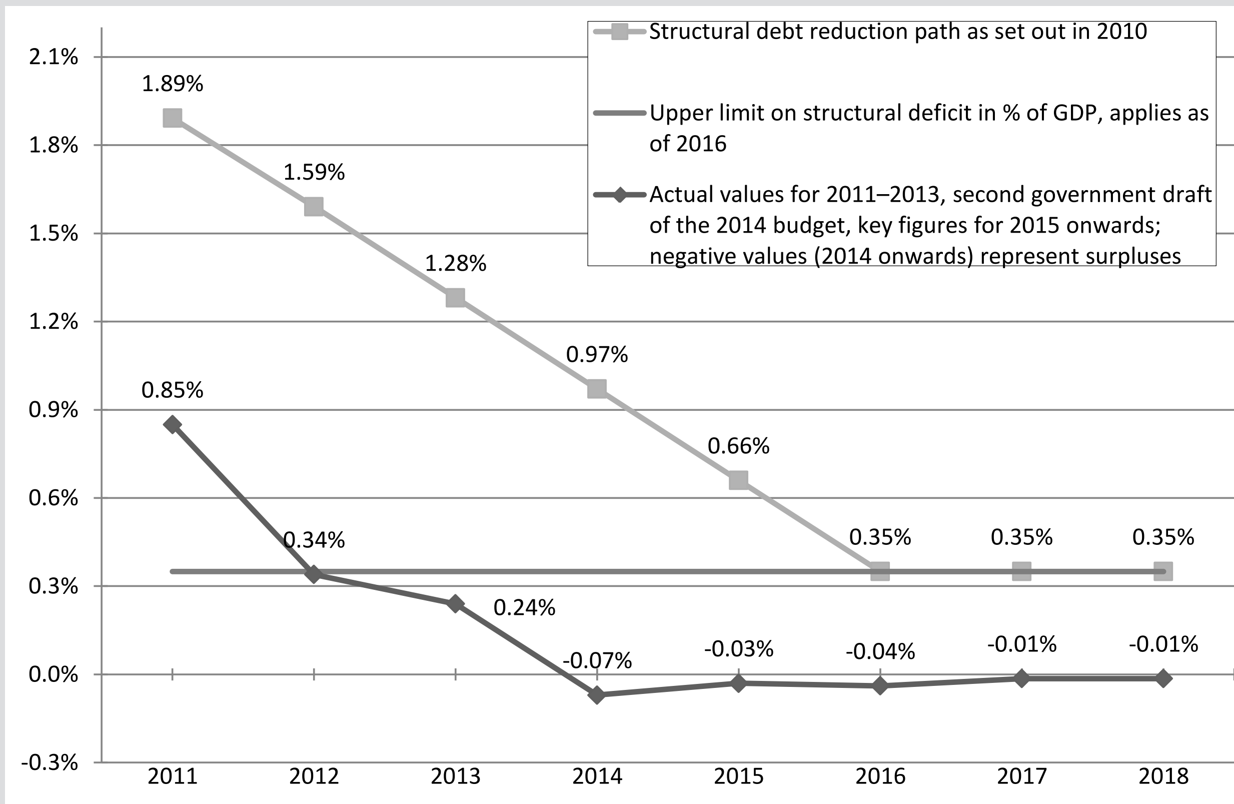
The consolidation successes of recent years are also reflected in debt levels. In 2013, total debt decreased by 2.6 percentage points to 78.4% of GDP, compared with the previous year. Hence Germany has also complied with the requirement to reduce public debt which has applied since the reform of the Stability and Growth Pact in 2011. This stipulates that the portion of the debt ratio above the Maastricht reference value of 60% of GDP must be reduced by an average of one-twentieth of the amount

each year (known as the 1/20 rule). Germany is already complying with this requirement in 2014 ahead of schedule; member states that, like Germany, were still in an excessive deficit procedure when the reform was passed in November 2011 are subject to a less ambitious transitional arrangement.

The positive trend in public finances means that Germany has also achieved one of the two consolidation goals that were agreed among the G20 members in 2010 (the G20 Toronto Commitments). This goal comprised halving the budget deficit between 2010 and 2013. Germany is also making good progress towards achieving the second goal, namely the stabilisation or reduction of the debt ratio by 2016. The federal government is forecasting that the debt ratio will keep falling for the rest of the projection period.

The Federation has made a significant contribution to the positive developments on all levels of government. Mirroring the general government trend, new borrowing has been significantly reduced. The structural deficit, which is the relevant measure for the debt brake, was reduced from 0.34% in 2012 to 0.24% in 2013. For the second year in a row, the Federation complied with the constitutionally stipulated debt-brake limit, which does not even apply until 2016. Hence the Federation has also successfully taken a first step towards making low levels of structural borrowing permanent, something which is central to long-term sustainable finances.

Figure 4: Change in the Federation's structural deficit (in % of GDP)



The figures do not take into account outstanding expenses of the special relief fund established to deal with damage caused by floods in May and June 2013. It cannot currently be predicted when the fund's remaining resources will be disbursed and in which year they will fall due.

One of the federal government's main goals is to secure what has already been achieved during the consolidation process. The federal government has set itself the targets of eliminating new borrowing and achieving a lasting reduction in its debt ratio. In a cabinet decision of 12 March 2014, the federal government adopted a structurally balanced budget for this year. In addition, the federal government has committed itself to balancing its budget without resorting to any new borrowing in the years beginning in 2015. The key figures for the 2015 federal budget and the financial plan up to 2018, which the federal cabinet adopted on 12 March 2014, also reflect this commitment.

Germany wants to reduce its debt level permanently and to do this significantly faster than stipulated in the European rules. The federal government's goal is to reduce the debt ratio to less than 60% of GDP within 10 years, with the intermediate target of bringing it under 70% by the end of 2017.

5.2 Fiscal policy measures on the expenditure and revenue side

Growth-friendly consolidation has paid off for Germany. Clear progress in improving public finances in recent years was accompanied by a robust economy which was reflected by a significant rise in employment. Germany has therefore given itself scope to combine its consolidation goals, which are both necessary and realistic, with targeted investment in areas that strengthen the factors driving growth. These include, in particular, further support for education, research and development as well as higher investment in transport infrastructure.

In its detailed analysis of March 2014 as part of the Macroeconomic Imbalance Procedure, the European Commission argues that the below-average level of investment in Germany is one cause of its current account surplus. In this context, please refer to the comments in the National Reform Programme. Moreover, the federal government will make the federal budget more strongly oriented towards investment and will further increase public investments in the coming years. Measures to provide financial relief for the *Länder* and local authorities have also been agreed and will improve investment capacity on this level.

Public investments already increased last year. In 2013, gross public investment grew by 3.5%, a noticeably higher rise compared with spending as a whole, which was up by 2.7%. The local authorities took advantage of their sound financial situation – which is partly due to measures taken by the Federation – to increase gross investment by over 12%. More than half of gross public investment is carried out on the local-authority level. As a result, it only took one year for local authorities to almost entirely make up for the decline in investment in 2012, which followed the expiry of stimulus measures under the Programme for Investment in the Future. At the same time, the implementation of federal measures to provide relief for local authorities, and debt relief and consolidation programmes undertaken by the *Länder* to benefit financially weak local authorities, will further enhance local authorities' scope for investment.

Together, the Federation, *Länder* and local authorities will increase public investment in education, research and development. Hence the federal government has committed itself to further boosting education funding in a joint effort between the Federation and the *Länder*. The *Länder* and local authorities face considerable challenges when it comes to financing pre-school childcare facilities, schools and higher education institutions. To help them tackle this challenge better, the *Länder* will receive relief totalling €6 billion during the current legislative period. In the event that the estimated resources for childcare are not sufficient to cope with the actual number of

children, these resources will be topped up to meet the demand.

Moreover, in 2014, the Federation and *Länder* will continue with the joint expansion of childcare, so that the legal requirement that all children between one and three years of age have the right to a place in a childcare facility (which has been in force since 1 August 2013) can be fulfilled and the quality of childcare increased. For the 2008–2014 period, the Federation has made funds totalling around €2.7 billion available for investment in this area, via the special federal fund for expanding childcare services. The Federation is also providing approximately €808 million in 2014 alone to cover operating costs, as part of the apportionment of VAT revenue.

Furthermore, the federal government has increased its financial commitments for the second phase of the 2020 Higher Education Pact, which goes until 2015, to some €7 billion. With these funds, the Federation is supporting the *Länder* with the creation of additional places for the greatly increased number of new university students. In recent years, Germany was able to significantly increase investment in research and development. As early as 2012, it almost reached the target under the Europe 2020 strategy, namely to boost investment in research and development to 3% of GDP. The federal government aims to keep R&D investment constant at 3% of GDP. The Federation continues to finance non-university research institutes, the Higher Education Pact, the Pact for Research and Innovation and the Initiative for Excellence. In the future, the Federation will be solely responsible for providing any additional funding needed for non-university research. A total of €3 billion is available for this purpose.

To date, resources have not yet been allocated for the education-related priority measures specified in the federal government's 2014 Annual Economic Report, namely the provision of "relief for the *Länder* and local authorities in terms of financing pre-school childcare facilities, school and higher education institutions" and the "financing of non-university research institutes, the Higher Education Pact, the Pact for Research and Innovation and the Initiative for Excellence". For 2014, a central provision of €500 million has been created for this purpose in the relevant departmental budget within the federal budget. This will be liquidated as part of the further budget preparation process once there is a final agreement on the allocation of funds.

With these measures, Germany is also complying with the country-specific recommendation that all levels of government should spend more on the growth-enhancing areas of education and research.

The federal government will substantially increase funding for federal transport infrastructure. Over the next four years, an additional €5 billion will be allocated for urgently needed investment in public transport infrastructure; these funds will primarily be used for maintenance. Of this total, €505 million will be made available in 2014. The 2014 federal budget also features an improved legal basis in budgetary law that will ensure planning and financial certainty in subsequent fiscal years. The Federation is also working on the further development of its broadband strategy together with telecommunication companies that are providing investment. The strategy's goals include nationwide access to broadband with a minimum speed of 50 Mbit/s by 2018.

The Federation is supporting the creation of sustainable urban structures through programmes to promote urban development. Moreover, the Federation is providing the *Länder* with financial assistance which will be supplemented by *Länder* and local authority resources. The federal government will increase federal funding for urban development, with an extra €600 million being made available in total over the coming four years. This means that the annual volume of spending and commitments will

reach €700 million. The programme will support local authorities in dealing with demographic, social and economic change and climate change. It will also help them cope with the negative impact of military base closures.

Seldom has the German labour market been so able to absorb new entrants. For this reason, the federal government is focussing its labour market policy on fighting long-term unemployment. The resources allocated for integrating jobseekers into the labour market will be increased by €1.4 billion by 2017. For this reason, the effective transferability of budgetary resources from one fiscal year to the next will be improved in the area of basic provision for jobseekers, with the aim of consolidating support payments.

In relation to development cooperation, Germany was the third biggest donor nation in absolute terms in 2012, according to OECD statistics, contributing around US$12.9 billion. The biggest donor was the US (around US$30.7 billion) followed by the United Kingdom (around US$13.9 billion). If the figures are adjusted for prices and exchange rates, then Germany actually came second. The federal government has committed itself to ensuring that Germany (whose Official Development Assistance ratio is currently 0.37% of gross national income) continues along its path towards the goal of a 0.7% ratio. To this end, a total of €2 billion will be made available during the current legislative period, including €200 million in 2014.

In order to secure the success of the transition to renewable energy (*Energiewende*), it is crucial that the relevant measures be made more cost-effective and that steps are taken to ensure that energy remains affordable for private consumers, businesses and the public sector. Key elements of the transformation of the energy system – for example, the expansion of the use of renewable energy in the transport sector and in the electricity market as well as the associated investments in grids and storage facilities – are being financed via consumer prices. The heating market is also being supported by public programmes based on stringent regulatory requirements.

In terms of other reforms, such as those related to the Renewable Energy Sources Act and the expansion of the distribution network, closer consideration must be paid to the cost-effectiveness of the overall system. In order to ensure an overall positive balance on the revenue side of public finances, it is essential to maintain the dynamism of industry in terms of innovation, investment and job creation – especially in relation to companies that compete internationally – and thereby maintain their capacity for generating tax revenues.

In January 2014, the federal cabinet adopted a draft law on improving benefits in the statutory pension scheme. This legislation aims to reward people who contributed to the stability of the pension system for decades by working, raising children or caring for others. In addition, the law provides better protection for people who have a reduced capacity to work. Furthermore, it ensures that demographic trends are taken into account when determining the rehabilitation budget. The federal budget will make a contribution to financing the improvements in benefits, not least because the pensions package also includes elements that benefit society as a whole. In this legislative period, the statutory pension insurance scheme will receive a federal subsidy that is almost €2 billion higher than was envisaged in the original financial planning. On the other hand, total federal subsidies will be increased in annual steps of €0.5 billion between 2019 and 2022 up to an annual total of €2 billion, which will then be carried forward in the future. In the long term, this additional contribution from the federal budget has a stabilising effect on increases in the pension contribution rate within the statutory pension insurance scheme.

A predictable, competition-friendly tax regulatory framework is a key component of growth-oriented fiscal policies. Against the background of stable revenue trends in Germany, public spending can be soundly financed with the existing tax base. Simplifying the tax system remains an ongoing task. In this respect, the federal government wants to move forward step by step. In particular, it wants to take advantage of the technical capabilities of modern data-processing technology and enhance electronic communication between taxpayers and the fiscal authorities.

The competitiveness of the German economy also depends on the appropriate further development of tax law. In terms of corporate taxation, the federal government will place the focus on further improving individual aspects of tax law while taking into consideration the special needs of small and medium-sized enterprises.

A fair system of tax law must put an emphasis on taxation according to the ability to pay. It must also ensure that nobody can evade their tax responsibilities at the expense of the general public. The federal government therefore wants to curb tax evasion and tax avoidance, particularly in relation to cross-border profit-shifting by multinational companies. It is also pushing for comprehensive transparency among tax administrations and steps to limit damaging tax competition. Another priority is better harmonisation of national tax regimes, with the aim of preventing companies from achieving non-taxation of income or double deduction of business expenses.

To this end, Germany is working together with its European and international partners in the OECD's Base Erosion and Profit Shifting (BEPS) initiative. In the event that the goals cannot be achieved by means of the G20/OECD BEPS initiative, the federal government will take measures on the domestic level. Furthermore, Germany is supporting the development of a global standard on automatic exchange of information on financial accounts, which is being coordinated on the OECD level. The aim is to establish this as an international standard.

The HGV toll will be further developed for the purposes of providing additional financing for the maintenance and expansion of the federal highway network. In addition, it is planned that an appropriate contribution (in the form of vignette charges) will be levied on owners of cars that are not registered in Germany. Furthermore, the future profits of the Federation's railway infrastructure enterprise will be completely reinvested in railway infrastructure.

More information on individual measures can be found in the National Reform Programme.

6. Projection of in general government budget balance and debt level

The positive trend in the general government fiscal balance and debt levels[1] became more firmly established in 2013, despite the economic slowdown at the beginning of the year. The medium-term budgetary objective of a structural deficit of a maximum of 0.5% of gross domestic product (GDP) will be complied with throughout the forecast period up until 2018. The continuation of policies focussed on growth-friendly consolidation guarantees that Germany's general government budget will be balanced and will help to reduce the debt ratio. Last year, the debt ratio fell to a level well below 80% of GDP, for the first time since 2009. During the period until the end of the Stability Programme's time frame, Germany aims to continually reduce the obligations that were taken on in connection with the financial crisis and the European sovereign debt crisis.[2] The financial progress that has been achieved lays the foundation for future-oriented investment decisions.

6.1 Trends in general government revenue and expenditure

Revenue ratio will remain stable

In 2013, the tax-to-GDP ratio was 23.2%. Tax revenues increased significantly in 2013, growing by 3.0% despite the economic slowdown at the beginning of the year. During the projection period up until 2018, tax revenues will continue to increase by between 3% and 4% per year. The average annual increase in the 2013–2018 period will be over 3.5%, meaning that tax revenues will continue to grow somewhat faster than nominal GDP. This is due both to rising incomes as well as to the fact that domestic demand, which is more tax-intensive, will make a larger contribution to overall economic activity than in the past. As a result, the tax-to-GDP ratio will increase slightly and then remain stable at around 23½% (Table 2).

1. Where not otherwise specified, all data are based on the 1995 European System of Accounts definition (Maastricht definition). The individual levels cover the core budget and off-budget entities.
2. The projection of general government accounts was completed on 2 April 2014.

In contrast, social insurance contributions, which constitute the second major component of general government revenue, have declined markedly in relation to GDP over the past 13 years, falling from 18.6% to 16.8%. Among other reasons, this is because net contribution rates have been reduced by 1.6 percentage points since 2000. Most recently, the contribution rate for statutory pension insurance was reduced from 19.6% to 18.9% on 1 January 2013. As a result of 2014 legislation on contribution rates, on 1 January 2014 the rate in the general pension insurance system was fixed at the level of the previous year. The goal is to ensure continuity, stability and planning certainty for the financing of the statutory pension insurance system, taking into account political and economic conditions. Consequently, the total tax ratio – the sum of the tax ratio and the social contribution ratio – will remain constant at around 40% over the forecast period.

The revenue ratio – which also includes other government revenue such as fees and revenue from business activities (e.g. profit transfers from the Deutsche Bundesbank) – will decline slightly from the 2013 level of 44.7% to around 44% in the coming years, because other revenue is expected to grow somewhat slower than GDP.

Table 2: Trends in the government revenue ratio

	2013	2014	2015	2016	2017	2018
			- % of GDP -			
Taxes	23.2	23 ½	23 ½	23 ½	23 ½	23 ½
Social contributions	16.8	16 ½	16 ½	16 ½	17	17
Taxes & social contributions	40.0	40	40	40	40	40
Total revenue						
April 2014 Update	**44.7**	**44 ½**	**44**	**44**	**44**	**44**
April 2013 Update	45	45	45	44 ½	44 ½	-

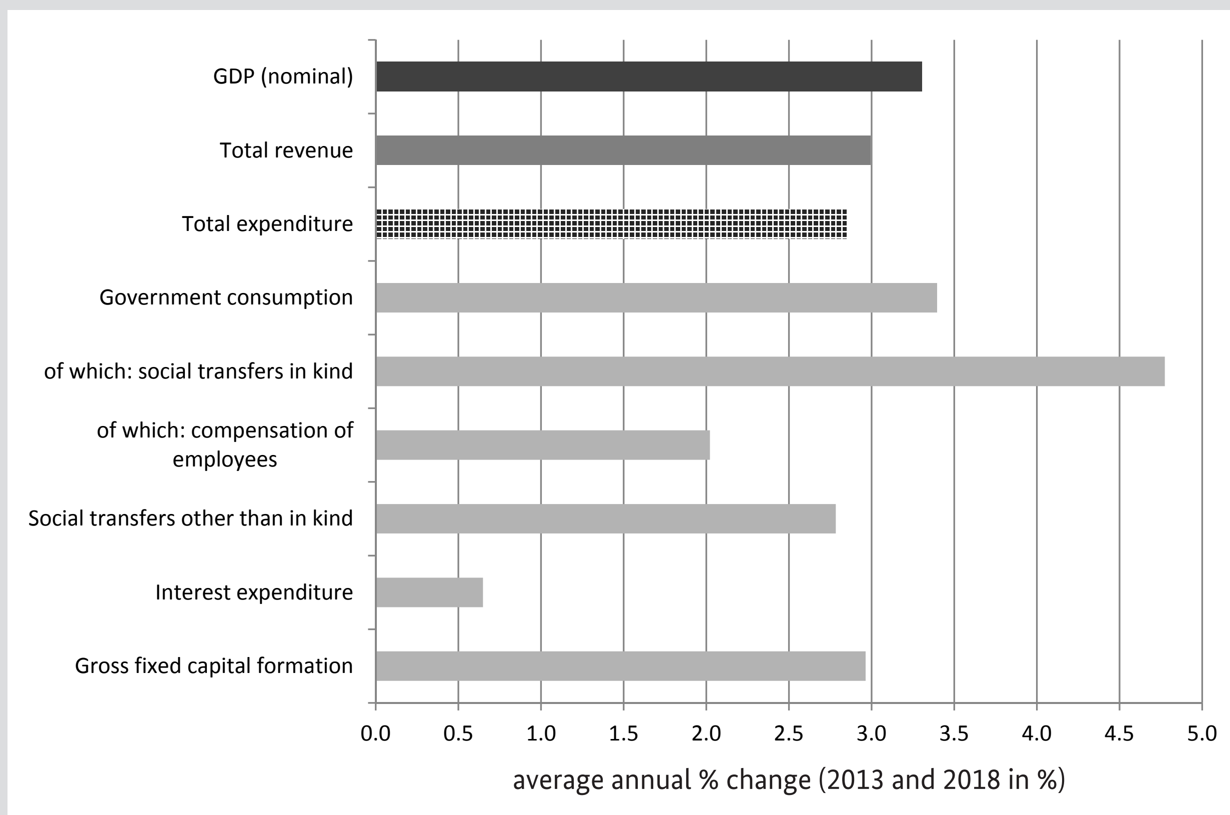
Any differences between (i) the “tax and social contribution ratio” and (ii) the sum of the “tax ratio” and the “social contribution ratio” are due to rounding; projection figures are rounded to half

Expenditures will increase on average at a lower rate than nominal GDP in the 2013–2018 period

Government expenditure grew by 2.7% in 2013. The increase in spending was slightly greater than the rise in revenue (2.5%) and lay in a similar range to nominal GDP growth. The expenditure trend was driven by a large increase in spending (5.0%) on benefits in kind, particularly in the area of statutory health insurance. Gross capital formation also rose more than average, by 3.5%. Interest expenditure continued to have a dampening effect on expenditure trends, falling by 7.4% compared with the previous year.

During the projection period, general government expenditure is expected to rise by an average of around 3% per year. Government consumption is expected to rise more than average, by 3½% per annum (Figure 5). The anticipated increase will mainly be the result of the continuing increase in benefits in kind, which will average almost 5% per annum. Gross capital formation will also expand by more than average during the projection period, by about 3% per year. In contrast, employment compensation expenditures are projected to rise at a below-average rate of about 2% per year. The other key categories of expenditure are expected to increase at a below-average rate as well. Of these, the largest increase will be posted by social benefits other than social transfers in kind, which are expected to grow by just under 3% per year. The government's fiscal consolidation policies have paid off in the form of low interest rates.

Figure 5: Average annual trends in general government revenue/expenditure and GDP trends from 2012 to 2017



In the medium term, moderate expenditure trends will cause the government expenditure ratio to decline: By the end of the projection period, government spending as a share of GDP is expected to decrease by one percentage point to around 43½% (Table 3).

Table 3: Trends in the government expenditure ratio

	2013	2014	2015	2016	2017	2018
			- % of GDP -			
April 2014 Update	**44.7**	**44 ½**	**44**	**44**	**44**	**43 ½**
April 2013 Update	45 ½	44 ½	44 ½	44 ½	44	-

Projection figures are rounded to half.

6.2 Trends in the general government fiscal balance

General government fiscal balance will remain in surplus in the medium term

In 2013, Germany achieved a balanced budget for the second year in a row. Following a general government fiscal surplus of 0.1% in 2012, the 2013 balance was 0.0% of GDP, despite the economic slowdown. The value is well below the Maastricht limit of a maximum deficit ratio of 3% of GDP. The federal government aims to maintain its sound budgetary position in the coming years. The general government budget will also remain balanced. The necessary economic and fiscal conditions are in place to ensure that balanced budgets become firmly established (Table 4).

Table 4: Trends in the general government balance

	2013	2014	2015	2016	2017	2018
			-in % of GDP-			
April 2014 Update	**0.0**	**0**	**0**	**0**	**½**	**½**
April 2013 Update	- ½	0	0	½	½	-

Projection figures are rounded to half.

Balanced budgets at all government levels from 2014 onwards

Although the Federation posted the highest deficit of all levels of government in 2013, at 0.2% of GDP, it succeeded in reducing its deficit ratio again compared with the previous year. The Federation's 2013 deficit is the smallest since 1991, with the exception of 2000, when the Federation achieved a surplus as a result of one-off revenues from the sale of UMTS licenses.

On the *Länder* level too, the deficit was significantly reduced in 2013 compared with the previous year, with the deficit ratio being cut by half to 0.1% of GDP. Surpluses were achieved once again on the level of the local authorities and the social security funds (Table 5). Viewed as a whole, the local authorities are in a sound financial position, partly due to support from the Federation. On this basis, they have significantly increased their gross capital formation by over 12% compared with 2012. Overall, more than half of public investment is carried out on the local-authority level.

Over the whole forecast period, the Federation and the *Länder* will contribute to a gradual improvement in the general government fiscal balance. On the federal level, this positive trend is underpinned by the government draft of the 2014 federal budget that was adopted by the cabinet on 12 March 2014 and the benchmark figures for financial planning up until 2018 that were also agreed on the same day. The government draft plans for a structurally balanced budget in 2014, while the benchmark figures envisage budgets in the years 2015 to 2018 that do not require any new borrowing at all. Accordingly, the federal budget will remain well below the permanent upper limit that will apply under the debt brake from 2016 onwards (i.e. a structural deficit no higher than 0.35% of GDP). A slight surplus is expected on the federal level in the coming years, supported by the sustainable consolidation of the Federation's core budget. The *Länder* as a whole will also achieve a balanced budget in the long term. The financial situation of local authorities will remain stable, although the situation of individual authorities varies widely.

The social insurance funds will achieve a close-to-balanced budget throughout the entire projection period. The substantial surpluses of recent years were largely the result of the consistently positive performance of the labour market, which served to boost revenues and to ensure that expenditures grew at only a moderate pace. In 2014, a variety of effects will converge: Revenues in the statutory health insurance system will decrease as a result of a reduction in the federal subsidy. Measures related to the pensions package will lead to an expansion of statutory pension payments over the whole forecast period. The decision not to reduce the pension contribution rate will help to stabilise revenues.

The surpluses of recent years, especially in the statutory pension and health insurance funds, allowed these systems to build up large financial reserves. Any small deficits that may arise during the projection period can be financed by using the reserves, so that the sustainability of the social insurance system is not compromised.

Table 5: Budget balances according to government level

	2013	2014	2015	2016	2017	2018
			- in % of GDP -			
Central government	-0.2	0	0	0	0	0
State government	-0.1	-0	0	0	0	0
Local government	0.1	0	0	0	0	0
Social security funds	0.2	-0	-0	-0	-0	-0
General government	**0.0**	**0**	**0**	**0**	**½**	**½**

Discrepancies in totals are due to rounding. Projection figures are rounded to half.

6.3 Trends in the general government structural balance

Medium-term budgetary objective will be met on a sustained basis

Germany has complied with the medium-term budgetary objective (MTO) of a general government structural deficit of a maximum of 0.5% of GDP since 2012. Last year, the structural balance for the Federation, *Länder*, local authorities and social security funds was 0.7% of GDP. Given that the actual general government fiscal balance fell only slightly compared with 2012, the improvement in the structural balance of around 0.5 percentage points is due to the economic slowdown (which manifested itself in an increase in the output gap) being taken into account, in arithmetic terms. Additional impacts were the result of one-off effects, which are not taken into account when calculating the structural balance. The one-off effects in 2013 were the result of (i) a ruling by the Federal Constitution Court on the unequal treatment of civil unions and marriages in terms of the income splitting method for married couples and (ii) additional expenditures and lower revenues associated with the adjustment programme for Greece, which was approved in November 2012.

As a result of the economy's dynamism in 2014 and in the coming years, the aggregate output gap is expected to shrink again significantly and, following the output gap closure rule, close completely in the final year of the projection period. The structural balance will continue to show a surplus of around ½% of GDP over the whole projection period. As a result, Germany will comply with its MTO by a clear margin in the 2014–2018 period (Table 6). Given that Germany will continue to more than fulfil its MTO, the expenditure rule of Article 5 of Council Regulation (EC) No 1466/97 is not binding, in accordance with the "Specifications on the implementation of the Stability and Growth Pact."

Table 6: Structural balance compared with actual balance and GDP trend

	2013	2014	2015	2016	2017	2018
Structural balance (% of GDP)	0.7	½	½	½	½	½
General government net borrowing/ net lending (% of GDP)	0.0	0	0	0	½	½
Real GDP (% change yoy)	0.4	1.8	2.0	1.4	1.4	1.4

Projection figures are rounded to half.

6.4 Sensitivity of projection of fiscal balance

The sensitivity analysis shows how the fiscal balance would develop in the event of deviations from the macroeconomic assumptions. The sensitivity analysis looks at two alternative scenarios which result from a reduction and an increase in the annual real GDP growth rate of a half percentage point, respectively, from 2014 to 2018. It is assumed that the GDP deflator and GDP composition remain constant vis-à-vis the baseline scenario.

Should nominal GDP growth amount to only 2½% per year (which corresponds to real growth of 1%), the actual balance would worsen across the projection period in purely arithmetic terms, resulting in a deficit of 1% of GDP (Table 7). In contrast, a more favourable GDP trend that was half a percentage point higher than in the baseline scenario would lead to an improvement in the fiscal balance of between 0.5 and 1 percentage points each year, resulting in significant surpluses.

Table 7: Sensitivity of projection of the general government budget balance

	2013	2014	2015	2016	2017	2018
GDP trends according to	**- general government budget balance in % of GDP -**					
- baseline scenario	0.0	0	0	0	½	½
- alternative scenarios						
• -1/2 pp p.a. compa- red to baseline		-0	- ½	- ½	-1	-1
• +1/2 pp p.a. compa- red to baseline		½	½	1	1 ½	1 ½

Projection figures are rounded to half.

6.5 Trends in debt levels

Germany is currently at the point where it can begin to reduce its debt ratio, which has been growing over decades. The necessary turnaround has been achieved. While the debt ratio had risen by 1.0 percentage points to 81.0% of GDP in 2012, in 2013 it sank by 2.6 percentage points to 78.4% of GDP. This decline was in large part due to the continued reduction of the portfolios of the resolution authorities that were established to deal with the consequences of the financial crisis, namely FMS Wertmanagement, which was set up to stabilise the Hypo Real Estate holding group, and the Erste Abwicklungsanstalt (EAA), which was established to wind up the former WestLB AG. The share of the debt-to-GDP ratio that is related to measures to deal with the financial crisis fell by 2.5 percentage points in 2013 to 8.6% of GDP. On the other hand, debt levels rose in 2013 in connection with measures to combat the European sovereign debt crisis, specifically the payment of the third and fourth tranches for the European Stability Mechanism (ESM) as well as loans from the European Financial Stability Facility (EFSF) to Greece, Ireland and Portugal. In 2013, the share of the debt-to-GDP ratio that is related to measures to fight the European sovereign debt crisis increased by 0.7 percentage points to 3.1% of GDP.

In 2014, the debt ratio is expected to fall again by around 2½ percentage points to 76% of GDP. While the impact of measures to combat the European sovereign debt crisis is stabilising, the effect of the financial crisis can be expected to decline again, by around one percentage point. The ongoing reduction of the portfolios of the resolution authorities as well as the positive budgetary trends in the Federation, *Länder* and local authorities will also lead in the medium term to a continued decline in the debt ratio, which will fall to around 65% by 2018 (Table 8).

As a result, further visible progress will be made in relation to compliance with the targets for the reduction of the debt ratio under the Stability and Growth Pact's 1/20 rule: Under the projection presented here, in every year of the projection period Germany will beat by a clear margin beat the benchmark that will apply from 2014 onwards under the 1/20 rule. In addition, the federal government's goal of reducing the debt ratio to less than 70% by the end of 2017 will be achieved and the foundations will be laid for the planned reduction to under 60% within 10 years.

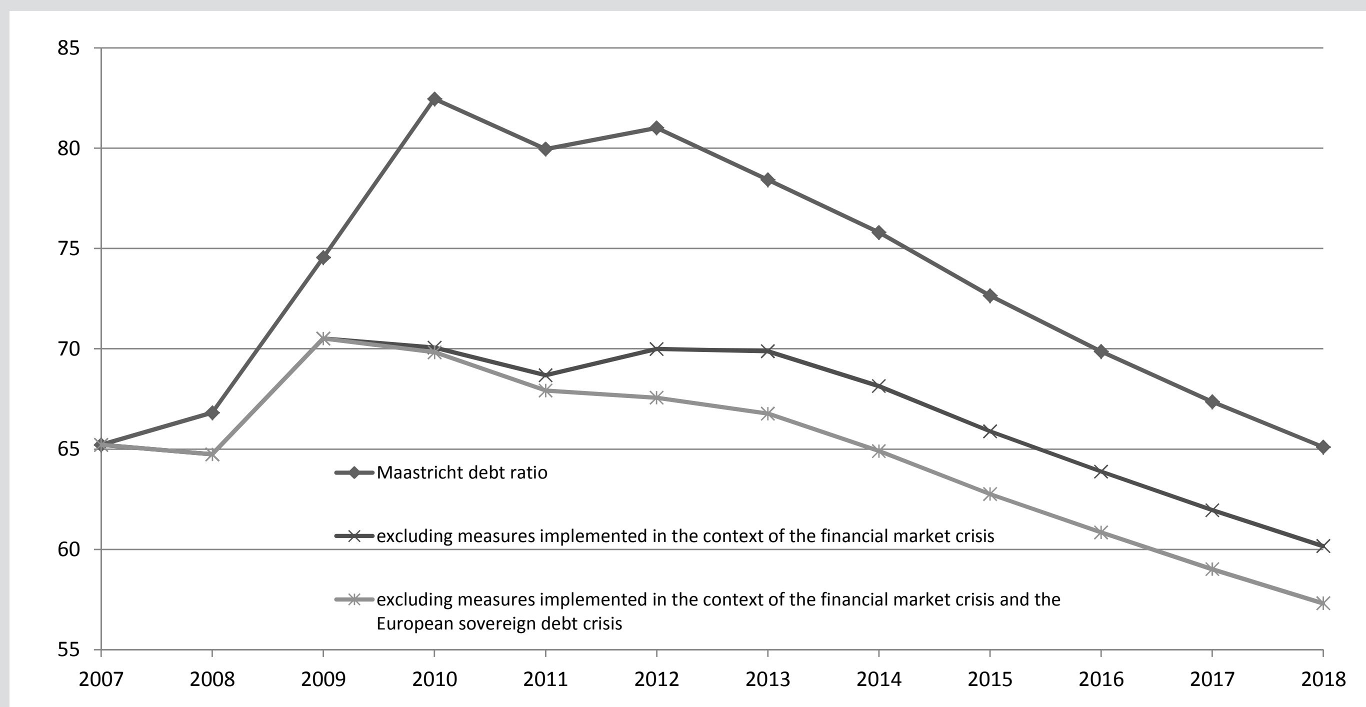
Table 8: Trends in the debt-to-GDP ratio

	2013	2014	2015	2016	2017	2018
	Debt ratio (% of GDP)					
April 2014 Update	**78.4**	**76**	**72 ½**	**70**	**67 ½**	**65**
April 2013 Update	80 ½	77 ½	75	71 ½	69	-

Projection figures are rounded to half.

Figure 6 illustrates the impact that measures taken in connection with the financial crisis and the European sovereign debt crisis have had on the development of Germany's debt-to-GDP ratio (Maastricht definition). Since 2008 in particular, measures to cope with the financial crisis have had a major impact on the development of the debt ratio. The winding down of these measures will also play a key role in reducing the debt-to-GDP ratio during the period to 2018. The impact on the debt ratio of measures taken in connection with the European sovereign debt crisis has grown, especially since 2012, but these effects will be considerably outweighed by debt-reducing effects in the future. Due to the consolidation strategy that has been pursued, the debt-to-GDP ratio (adjusted for crisis-related effects) has shown a clear downward trend since 2010 and will already fall below 60% in 2017.

Figure 6: Effects on debt of stabilisation measures implemented in the context of the financial market crisis and the European sovereign debt crisis
Debt ratio - % of GDP-



7. Long-term sustainability and quality of public finances

7.1 Challenges to the sustainability of public finances

Ongoing demographic change in Germany poses significant risks to the sustainability of public finances, especially from 2030 onwards. According to the 12th coordinated population projection of the Federation and *Länder*, Germany's resident population will have shrunk significantly by 2060. In the long term, the proportion of people of working age will decline considerably, while the proportion of people aged 65 or older will increase significantly. Assuming that other variables remain the same, the ageing population will cause an increase in age-related expenditure in relation to economic output. At the same time, it will lead to a slower increase in public revenues.

In order to address the social challenges caused by demographic change in good time, the federal government presented a comprehensive inter-ministerial demographic strategy in 2012. Sound public finances are a central pillar of this strategy and are essential if the state wants to retain its ability to take effective action in the long term. In October 2012, a dialogue and working-group process including representatives of the *Länder*, local authorities, social partners, associations, industry, academia and civil society was launched with the aim of developing and implementing measures to deal with demographic change in central policy areas. The first results of this work were presented at a demography summit in May 2013. The federal government will keep developing its demographic strategy during this legislative period and will continue the dialogue and working-group process.

7.2 Government revenue and expenditure from a long-term perspective

Once in every legislative period, the Federal Ministry of Finance reports on the sustainability of public finances, so that long-term fiscal risks are considered at an early stage. The current third sustainability report, which was published in the autumn of 2011, contains sustainability analyses prepared by external researchers for the period up until 2060. In addition, the Federal Ministry of Finance commissions interim updates when necessary.

Currently, findings are available from an interim update that takes 2012 as its base year. The calculations, which repre-

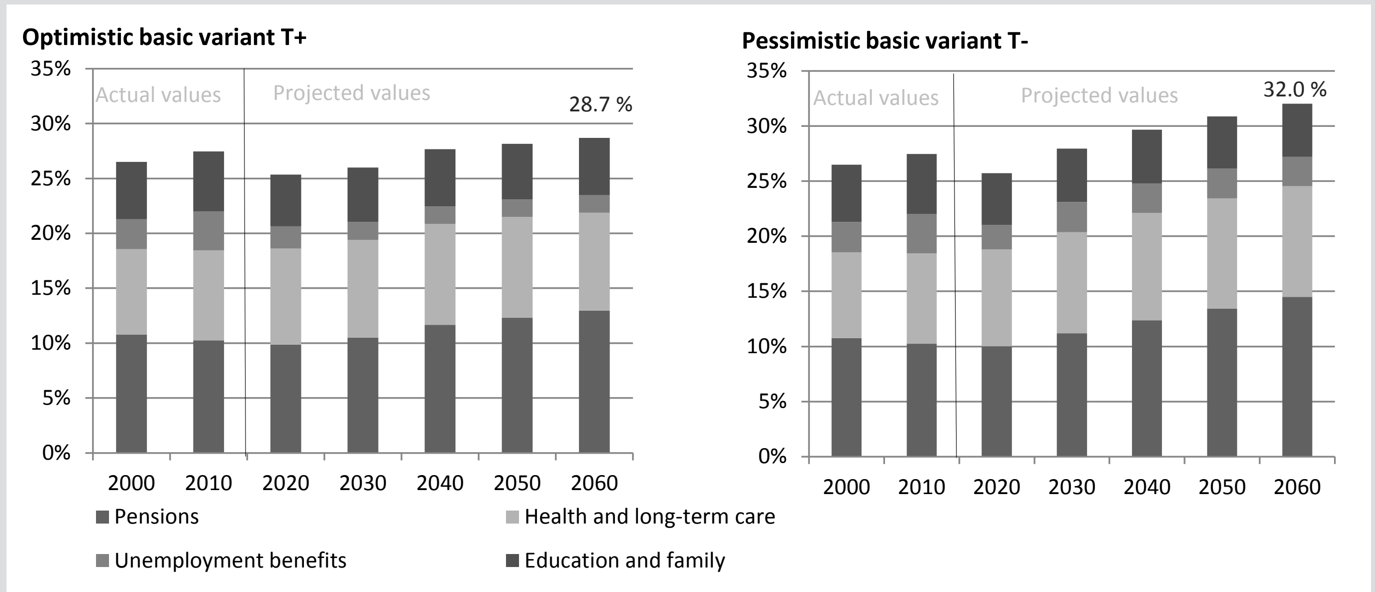
sent a kind of early-warning mechanism, make projections about public spending, revenue trends and trends in the general government debt ratio within the context of demographic change[3]. They assume that current policies, based on the legislation in force at the start of 2013, are continued unchanged. The national calculations are geared towards reflecting national characteristics in as much detail and as accurately as possible. For this reason, their results are not directly comparable with the results of projections on the European level. Despite similarities in the basic approach, there are deviations between the national report on the one hand and the EU's Ageing Report and the Commission's Fiscal Sustainability Report on the other in terms of the scope of the report, individual methodological components, underlying data and definitions of terms.

The age-related public spending considered in the projections (pensions, healthcare, long-term care, unemployment payments, education and family support) was equivalent to 25.9% of GDP in the base year of 2012 and comprises around 58% of all public spending. According to the projections' results and under their assumptions, age-related spending will rise to between 28.7% and 32.0%[4] of GDP by 2060 and will therefore lie between 2.8 and 6.1 percentage points above the level of the 2012 base year. Under the supposition that spending (with the exception of interest payments for existing debts) and revenue will remain constant as a percentage of GDP, explicit government debt in relation to economic output would increase significantly in the long term if policies do not change. The sustainability gap (in the sense of the S2 sustainability indicator) would be between 0.6% and 3.1% of GDP. The general government primary balance would have to be immediately and permanently reduced by this value, in order to make sure that all explicit and implicit obligations can be met in the long term.

3. Given that no up-to-date official population projections are currently available, the calculations were not based on the results of the coordinated population projection, as is usually the case, but on the results of a population model developed by Professor Martin Werding of Ruhr-Universität Bochum. This model takes into account the first results from the 2011 census. Its long-term assumptions are closely based on the 12th coordinated population projection of the Federation and *Länder*, which dates from 2009.

4. Two basic variants are always shown to emphasise the fact that calculations with a projection period of almost 50 years can only be a modelling exercise. The "T-" basic variant is based throughout on slightly pessimistic (in terms of their effects on fiscal sustainability) assumptions about future demographic, labour market and macroeconomic trends. The "T+" basic variant is based throughout on slightly optimistic assumptions.

Figure 7: Forecasts for age-related public spending until 2060 (in % of GDP)



Sources: DRV, BMG, BA, BMAS, BMF, BMFSFJ ((provisional) actual values for 2000 and 2010), Werding/ifo (2014) (projections for 2020 onwards)

Sensitivity analyses show that lower unemployment, rising labour force participation on the part of older workers and women and increased immigration of qualified workers could mitigate the impact of demographic change on public finances. The analyses also reveal that the consolidation course taken to date and past reforms have had positive effects on long-term sustainability.

7.3 Measures to maintain long-term sustainability

Germany has a permanent fiscal-policy framework to ensure sustainable public finances in the form of the debt brake and the fiscal rules enacted on the European level. Rigorous compliance with these rules requires early, forward-looking action, not only in the area of fiscal policy but also in all other policy areas.

For example, in the area of social long-term care insurance, a Long-Term Care Provision Fund will be introduced that will help to mitigate future increases in contributions and will increase the financial sustainability of long-term care insurance in the medium to long term. In order to better cope with the needs of recipients of long-term care and their relatives in an ageing society, care services will be expanded and made more flexible and the contribution rate for social long-term care insurance will be increased by a total of 0.5 percentage points in two steps. Of this, 0.1 percentage points of the contribution rate will be used to set up the Long-Term Care Provision Fund. The measures to support private provisions for long-term care that were introduced on 1 January 2013 also help to create a social insurance system that ensures intergenerational equity. By promoting private fully-funded supplementary long-term care insurance, the financing of future care needs is being placed on a broader – and therefore more

sustainable – basis. The coalition agreement pledges that the options contained in two separate pieces of legislation governing leave from work to care for relatives and financial support for people taking such leave will be combined in one law with a legal entitlement to take advantage of these options. These benefits will be developed further with the aim of making it easier to balance work commitments with caring for a relative.

In the area of statutory pension insurance, Germany implemented important reforms in the past, including the gradual increase of the statutory retirement age to 67 by 2029, the introduction of a sustainability factor in the pension adjustment formula and support for supplementary fully-funded pensions. In order to ensure that the fiscal and economic consequences of demographic change are distributed fairly among younger and older generations, German pension law provides for upper limits on contribution rates and for guaranteed minimum pension levels. On 29 January 2014, the federal cabinet adopted draft legislation aimed at improving benefits in the statutory pension system. The additional spending that arises as a result will be financed in the medium term by waiving a reduction in the contribution rate and in the long term through additional funds from the Federation, which will be gradually increased to an annual level of around €2 billion by 2022. The statutory upper limit on contribution rates and the minimum pension level for 2030 will be adhered to.

The federal government's economic policy measures are aimed at strengthening potential growth, thereby enhancing the long-term sustainability of public finances. This also involves securing the long-term labour supply. On the basis of Germany's social market economy, which is characterised by a strong social partnership, the federal government is placing its focus on an open and well functioning labour market. This includes improving equal opportunities for men and women, achieving a higher proportion of women in leadership positions as well as improving opportunities for disadvantaged individuals to participate in the labour market. Current studies indicate that it is still difficult for many unemployed people to get back into employment. It is therefore important to counteract the structural fossilisation of long-term unemployment at an early stage. The Federation and *Länder* have developed a plan which, on the basis of principles that have already been developed, identifies strategically viable approaches for sustainably integrating the long-term unemployed into the workforce, so they can support themselves. These approaches can be implemented without amending existing laws.

The federal government's Skilled Labour Strategy is designed to secure a sufficient long-term supply of skilled workers through measures covering five priority areas. It is aimed both at exploiting new sources of skilled workers as well as improving general qualification levels. The federal government's Skilled Labour Strategy is aimed primarily at people in Germany, but is also intended to attract skilled workers from abroad.

Making it easier for employees to balance work and family obligations helps to promote parents' participation in the labour force and enhances the economic stability of families. The federal government supports family-friendly working conditions, particularly flexible working hours and a better division of family-related and professional obligations between parents. For example, the federal government plans to make provisions on parental leave and child-raising allowance more flexible.

To ensure that all decisions and policies take demographic trends into account, draft legislation and guidelines must be examined to assess their impact on demographic change and future generations ("demogra-

phy check”). Germany’s National Reform Programme contains additional details on these and other measures.

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

In order to guarantee that Germany also has financial leeway in the future, it will be increasingly important to enhance the efficiency and effectiveness of public finances and to allocate the limited public resources to areas that promote growth. The federal government has committed itself to comprehensive disclosure of the impact of plans affecting finances both on the spending and revenue side. It will also subject subsidies to constant monitoring in accordance with subsidy-policy guidelines. According to the latest 24th Subsidy Report, which covers subsidies granted during the 2011–2014 period, evaluations were conducted by external auditors or the Federal Court of Audit on 74% of the total volume of subsidies granted in the form of tax concessions and on 62% of the total volume of subsidies granted in the form of financial assistance. Furthermore, the federal government will, as part of its Subsidy Report, monitor the sustainability of measures more closely.

The federal government will take various measures to increase the efficiency and quality of healthcare. As part of legislation to improve the financial structure and quality of statutory health insurance (*Gesetz zur Weiterentwicklung der Finanzstruktur und Qualität in der gesetzlichen Krankenversicherung or GKV-FQWG*), the decoupling of wage costs from health spending is to be continued. This will ensure that financial resources in the statutory health insurance system are organised in a way that promotes employment. Furthermore, the health system’s competition-based approach will be further enhanced in order to increase the cost-effectiveness and quality of healthcare provision. As part of the GKV-FQWG financing reforms which are scheduled to be adopted as early as the summer of 2014, the health insurance funds will be given more autonomy when it comes to setting contribution rates. This will create important incentives for price-based competition, which will promote efficiency. Moreover, as part of broad-based measures promoting a focus on quality in outpatient and inpatient care, a range of improvements will be implemented in order to increase the transparency of treatment quality, thereby enhancing quality-based competition. For example, this will include founding a new quality institute which will develop meaningful performance indicators and reliable databases that will enable users to compare the quality of care in a way that is comprehensible and transparent.

During the further implementation of the transformation of the energy system, there will be a greater focus on cost-effectiveness, efficiency, planning certainty and reliability. By the end of April 2014, the federal government will present its proposal for a fundamental reform of the Renewable Energy Sources Act, which aims to slow the previous trend of rising costs in order to limit increases in electricity prices for end users.

The federal government’s measures to combat tax avoidance and tax evasion (please refer to Chapter 5.2) will help to make sure that the tax revenue to which the government is entitled can be collected even more effectively in the future. Similarly, progress in the modernisation of the taxation procedure will simplify the use of tax law in practice and make its implementation even more efficient.

Further information on individual measures can be found in the National Reform Programme.

Annex

Page

Table 9: Forecast of macroeconomic trends ... 44
Table 10: Price developments – deflators ... 45
Table 11: Labour market trends ... 46
Table 12: Sectoral balances ... 47
Table 13: General government budgetary prospects ... 48
Table 14: No-policy change projections ... 50
Table 15: Amounts to be excluded from the expenditure benchmark ... 50
Table 16: General government debt developments ... 50
Table 17: Cyclical developments ... 51
Table 18: Divergence from previous update ... 52
Table 19: Long-term trends in age-related general government expenditure ... 53
Table 20: Technical assumptions ... 54
Table 21: Contingent liabilities ... 54

Table 9: Forecast of macroeconomic trends

	ESA Code	2013 Index 2005=100	2013	2014	2015	2016 to 2018 (3)
			% change p.a.			
1. Real GDP, chain index	B1g	111.60	0.4	1.8	2.0	1 ½
2. Nominal GDP (€bn)	B1g	2737.6	2.7	3.4	3.7	3
Components of real GDP, chain index						
3. Private consumption expenditure (1)	P.3	107.46	0.9	1.4	1.6	1 ¼
4. Government consumption expenditure	P.3	113.15	0.7	1.9	1.5	1 ¼
5. Gross fixed capital formation	P.51	111.44	-0.7	3.5	5.0	2 ¾
6. Changes in inventories (GDP growth contribution) (2)	P.52 + P.53	-	0.0	0.1	0.0	0
7. Exports	P.6	141.41	0.8	4.1	4.8	4 ¾
8. Imports	P.7	139.05	0.9	5.0	5.5	5 ¼
Contributions to real GDP growth (2)						
9. Domestic demand (excluding stocks)		-	0.7	1.8	2.1	1 ½
10. Changes in inventories	P.52 + P.53	-	0.0	0.1	0.0	0
11. External balance of goods and services	B.11	-	-0.3	-0.1	0.0	-0

2013: Federal Statistical Office, February 2014
2014 and 2015: results of the short-term forecast for the 2014 Annual Projection, February 2014
2016 to 2018: results of the medium-term forecast for the 2014 Annual Projection, February 2014

(1) Including private non-profit organisations serving households
(2) Contribution to GDP growth rate
(3) Values rounded to ¼

Table 10: Price developments – deflators

	ESA Code	2013 Index 2005=100	2013	2014	2015	2016 to 2018 (2)
			% change p.a.			
1. GDP		110.28	2.2	1.7	1.7	1 ¾
2. Private consumption expenditure (1)		111.96	1.6	1.5	1.7	1 ¾
3. Government consumption expenditure		112.89	2.9	2.0	2.0	1 ¾
4. Gross capital formation		108.02	0.8	1.3	1.4	1 ¼
5. Exports		106.60	-0.5	0.4	1.0	1
6. Imports		108.52	-1.8	0.1	1.1	1

2013: Federal Statistical Office, February 2014
2014 and 2015: results of the short-term forecast for the 2014 Annual Projection, February 2014
2016 to 2018: results of the medium-term forecast for the 2014 Annual Projection, February 2014

(1) Including private non-profit organisations serving households
(2) Values rounded to ¼

Table 11: Labour market trends

	ESA Code	2013	2013	2014	2015	2016 to 2018 (6)
		Index 2005=100	% change p.a.			
1. Employment, persons (domestic) (1) (m)		41.8	0.6	0.6	0.3	¼
2. Employment, hours worked (2) (bn hours)		58.1	0.2	0.5	0.8	¼
3. Unemployment rate (3) (%)		-	5.1	4.9	4.9	4
4. Labour productivity (4) (2005=100)		104.0	-0.1	1.2	1.7	1 ¼
5. Labour productivity (5) (2005=100)		107.2	0.3	1.3	1.2	1 ¼
6. Compensation of employees (€bn)	D.1	1414.2	2.8	3.2	3.4	2 ¾
7. Compensation per employee (thousand €)		37.9	2.0	2.6	3.1	2 ¾

2013: Federal Statistical Office, February 2014
2014 and 2015: results of the short-term forecast for the 2014 Annual Projection, February 2014
2016 to 2018: results of the medium-term forecast for the 2014 Annual Projection, February 2014

(1) Employed persons, domestic concept
(2) National accounts definition
(3) Unemployed (ILO) / labour force
(4) Real GDP per person employed
(5) Real GDP (adjusted for inflation) per hour worked
(6) Values rounded to ¼; unemployment rate: value displayed is value for last year of forecast (2018)

Table 12: Sectoral balances

	ESA Code	2013	2014	2015	2016 to 2018 (1)
			% change p.a.		
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	7.4	6.8	6.5	6
of which:					
- Balance on goods and services		6.3	5.9	5.7	5 ¼
2. Net lending/borrowing of households	B.9	5.0	4.9	4.6	4 ½
3. Net lending/borrowing of general government	EDP B.9	0.0	0	0	½
4. Statistical discrepancy		-	-	-	-

2013: Federal Statistical Office, February 2014
2014 and 2015: results of the short-term forecast for the 2014 Annual Projection, February 2014
2016 to 2018: results of the medium-term forecast for the 2014 Annual Projection, February 2014

(1) Values rounded to ¼; value for last year of forecast (2018)

Table 13: General government budgetary prospects

	ESA Code	2013	2013	2014	2015	2016	2017	2018
		bn. €			% of GDP			
Net lending (EDP B.9) by sub-sector								
1. General government	S. 13	0.2	0.0	0	0	0	½	½
2. Central government	S. 1311	-6.7	-0.2	0	0	0	0	0
3. State government	S. 1312	-3.2	-0.1	-0	0	0	0	0
4. Local government	S. 1313	3.5	0.1	0	0	0	0	0
5. Social security funds	S. 1314	6.6	0.2	-0	-0	-0	-0	-0
General government (S.13)								
6. Total revenue	TR	1,223.4	44.7	44 ½	44	44	44	44
7. Total expenditure	TE (1)	1,223.2	44.7	44 ½	44	44	44	43 ½
8. Net lending/borrowing	EDP B.9	0.2	0.0	0	0	0	½	½
9. Interest expenditure	EDP D. 41	59.1	2.2	2	2	2	2	2
10. Primary balance (2)		59.3	2.2	2	2	2	2	2
11. One-off and other temporary measures (3)		-0.9	0.0	-0	-0	-0	-0	-0
Selected components of revenue								
12. Total taxes (12=12a+12b+12c)		636.4	23.2	23 ½	23 ½	23 ½	23 ½	23 ½
12a. Taxes on production and imports	D.2	303.0	11.1	11	11	11	10 ½	10 ½
12b. Current taxes on income, wealth, etc	D.5	333.4	12.2	12 ½	12 ½	12 ½	12 ½	12 ½
12c. Capital taxes	D.91	0.0	0.0	0	0	0	0	0
13. Social contributions	D.61	459.1	16.8	16 ½	16 ½	16 ½	17	17
14. Property income	D.4	21.1	0.8	1	½	½	½	½
15. Other (4)		106.8	3.9	3 ½	3 ½	3 ½	3 ½	3
16. = 6. Total revenue	TR	1,223.4	44.7	44 ½	44	44	44	44
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995) (5)		1,095.5	40.0	40	40	40	40	40

	ESA Code	2013	2013	2014	2015	2016	2017	2018
		bn. €	% of GDP					
Selected components of expenditure								
17. Compensation of employees + intermediate consumption	D.1+P.2	343.5	12.5	12 ½	12 ½	12	12	12
17a. Compensation of employees	D.1	208.4	7.6	7 ½	7 ½	7 ½	7	7
17b. Intermediate consumption	P.2	135.2	4.9	5	5	5	4 ½	4 ½
18. Social payments (18=18a+18b)		663.9	24.3	24 ½	24 ½	24 ½	24 ½	24 ½
of which: unemployment benefits (6)		46.0	1.7	1 ½	1 ½	1 ½	1 ½	1 ½
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	223.9	8.2	8 ½	8 ½	8 ½	8 ½	9
18b. Social transfers other than in kind	D.62	440.1	16.1	16	16	16	15 ½	15 ½
19. = 9. Interest expenditure	EDP D.41	59.1	2.2	2	2	2	2	2
20. Subsidies	D.3	25.7	0.9	1	1	1	1	1
21. Gross fixed capital formation	P.51	42.7	1.6	1 ½	1 ½	1 ½	1 ½	1 ½
23. Other (7)		88.2	3.2	3	3	3	3	3
24. = 7. Total expenditure	TE (1)	1,223.2	44.7	44 ½	44	44	44	43 ½
p.m.: Government consumption (nominal)	P.3	533.0	19.5	19 ½	19 ½	19 ½	19 ½	19 ½

1. Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.
2. The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).
3. A plus sign means deficit-reducing one-off measures.
4. P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).
5. Including those collected by the EU and including an adjustment for uncollected taxes and social 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+D.4 (other than D.41)+ D.5+D.7+P.52+P.53+K.2+D.8.

Figures for the forecast years are rounded to half a percentage point of GDP.

Table 14: No-policy change projections

	2013	2013	2014	2015	2016	2017	2018
	bn €	% of GDP					
1. Total revenue at unchanged policies	1,223.4	44.7	44 ½	44	44	44	44
2. Total expenditure at unchanged policies	1,223.2	44.7	44 ½	44	44	44	43 ½

Figures for the forecast years are rounded to half a percentage point of GDP.

Table 15: Amounts to be excluded from the expenditure benchmark

	2013	2013	2014	2015	2016	2017	2018
	bn. €	% of GDP					
1. Expenditure on EU programmes fully matched by EU funds revenue	0.0	0.0	0	0	0	0	0
2. Cyclical unemployment benefit expenditure	-3.4	-0.1	-0	0	0	0	-0
3. Effect of discretionary revenue measures	-0.4	0.0	0	0	0	0	0
4. Revenue increases mandated by law	-6.7	-0.2	-0	-0	-0	-0	-0

Figures for the forecast years are rounded to half a percentage point of GDP.

Table 16: General government debt developments

	ESA Code	2013	2014	2015	2016	2017	2018
		% of GDP					
1. Gross debt		78.4	76	72 ½	70	67 ½	65
2. Change in gross debt ratio		-2.6	-2 ½	-3	-3	-2 ½	-2 ½
Contributions to changes in gross debt							
3. Primary balance		2.4	2	2	2	2	2
4. Interest expenditure	EDP D.41	2.4	2	2	2	2	2
5. Stock-flow adjustment		-0.5	0	- ½	- ½	-0	0
p.m.: Implicit interest rate on debt (1)		2.7	2 ½	2 ½	2 ½	2 ½	3

1. Proxied by interest expenditure divided by the debt level of the previous year.
Figures for the forecast years are rounded to half a percentage point of GDP.

Table 17: Cyclical developments

	ESA Code	2013	2014	2015	2016	2017	2018
				% of GDP			
1. Real GDP growth (%)		0.4	1.8	2.0	1.4	1.4	1.4
2. Net lending of general government	EDP B.9	0.0	0	0	0	½	½
3. Interest expenditure	EDP D.41	2.4	2	2	2	2	2
4. One-off and other temporary measures (1)		0.0	-0	-0	-0	-0	-0
5. Potential GDP growth (%)		1.5	1.5	1.5	1.3	1.3	1.3
contributions:							
- labour		0.5	0.5	0.4	0.2	0.1	0.1
- capital		0.4	0.4	0.4	0.4	0.4	0.5
- total factor productivity		0.5	0.6	0.7	0.7	0.7	0.8
6. Output gap		-1.2	-0.9	-0.4	-0.3	-0.1	0.0
7. Cyclical budgetary component		-0.7	- ½	-0	-0	-0	0
8. Cyclically-adjusted balance (2 - 7)		0.7	½	½	½	½	½
9. Cyclically-adjusted primary balance (8 + 3)		3.0	2 ½	2	2	2	2
10. Structural balance (8 - 4)		0.7	½	½	½	½	½

1. A plus sign means deficit-reducing one-off measures.
Figures for the forecast years are rounded to half a percentage point of GDP.

Table 18: Divergence from previous update

	ESA Code	2013	2014	2015	2016	2017	2018
				% of GDP			
Real GDP growth (%)							
Previous update		0.4	1.6	1.4	1.4	1.4	-
Current update		0.4	1.8	2.0	1.4	1.4	1.4
Difference		0.0	0.1	0.6	0.0	0.0	-
General government net lending (% of GDP)	EDP B.9						
Previous update		- ½	0	0	½	½	-
Current update		0.0	0	0	0	½	½
Difference		½	-0	-0	-0	- ½	-
General government gross debt (% of GDP)							
Previous update		80 ½	77 ½	75	71 ½	69	-
Current update		78.4	76	72 ½	70	67 ½	65
Difference		-2	-2	-2	-2	-1 ½	-

Figures for the forecast years are rounded to half a percentage point of GDP.

Table 19: Long-term trends in age-related general government expenditure

	2010	2020	2030	2040	2050	2060
	Expenditure in % of GDP (pessimistic basic variant "T-" / optimistic basic variant "T+")					
Pension expenditure (1)	10.3	10.0/9.9	11.2/10.5	12.4/11.7	13.4/12.3	14.5/13.0
Healthcare expenditure (2) on statutory health insurance and medical assistance payments for civil servants	7.3	7.8/7.8	8.2/8.0	8.7/8.3	8.9/8.3	8.9/8.2
Long-term care expenditure (3)	0.9	0.9/0.9	1.0/0.9	1.1/0.9	1.2/0.9	1.1/0.8
Unemployment benefits (4)	3.5	2.2/2.0	2.7/1.6	2.7/1.6	2.7/1.6	2.7/1.6
Spending on education and childcare (5)	3.7	3.3/3.3	3.4/3.5	3.4/3.7	3.3/3.6	3.3/3.6
Expenditure on the family benefits system (6)	1.9	1.4/1.4	1.5/1.5	1.5/1.6	1.4/1.5	1.5/1.6
Total age-related expenditure	27.6	25.7/25.4	27.9/26.0	29.7/27.7	30.9/28.2	32.0/28.7
	Assumptions					
Productivity growth (%) (7)	0.5	1.5/1.5	1.9/2.1	1.7/2.0	1.6/1.8	1.6/1.9
GDP growth (%)	1.3	1.3/1.6	0.9/1.6	1.1/1.6	0.9/1.6	0.8/1.5
Labour force participation rates (%)						
- Men (15 to 64)	84.1	86.0/85.4	86.9/86.8	87.2/86.5	87.0/86.4	87.2/86.8
- Women (15 to 64)	73.9	79.4/78.1	81.5/80.7	82.1/80.7	81.9/80.5	82.3/80.9
Unemployment rate (%)	6.8	4.4/4.0	5.8/3.4	5.8/3.4	5.8/3.4	5.8/3.4
Old-age dependency ratio	31.1	36.1/35.4	48.9/46.4	57.1/51.5	60.4/51.6	64.9/53.3
Total population (m)	81.7	79.6/80.5	77.5/80.0	74.6/78.8	70.9/76.9	66.8/75.1
Population aged 65+ (m)	16.8	18.5/18.3	22.3/21.8	24.0/23.2	23.7/22.8	23.3/22.6

Table 19: Continuation

The values shown have been consolidated to take into account cross-payments between individual sub-budgets. Last update of the (provisional) actual values for 2010: February 2014. Last update of the projections (2020–2060): 2012 base year, data and legal situation as of 1 January 2013.

Sources: (provisional) actual values for 2010: 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 (2020–2060): Professor Martin Werding in cooperation with the ifo Institute (2014), interim update on behalf of the Federal Ministry of Finance.
(1) Statutory pension insurance and civil servants' pensions
(2) Statutory health insurance and medical assistance payments for civil servants and eligible relatives
(3) Long-term care insurance
(4) Unemployment insurance, other expenses of the Federal Employment Agency and basic provision for jobseekers (including accommodation costs)
(5) Public education spending (including childcare facilities) according to the definition used in the Education Finance Report (without considering funds for research and development at higher education institutions)
(6) Child benefit, tax-free allowances for children under the Income Tax Act, parental benefit
(7) Measured by labour productivity
Comments: The figures shown reflect two variants: "T-", which is based throughout on slightly pessimistic assumptions, and "T+", which is based throughout on slightly optimistic assumptions. Figures on productivity growth and GDP growth refer to changes compared with the previous year. The old-age dependency ratio is based on the definition of a working-age population as aged 15-64.

Table 20: Technical assumptions

	2013	2014	2015	2016	2017	2018	2016 to 2018
Short-term interest rate (annual average in %)	0.5	0.25	0.25	0.25	0.25	0.25	0.25
USD/€ exchange rate (annual average)	1.33	1.36	1.36	1.36	1.36	1.36	1.36
Growth of German sales markets (in %) (1)	1.6	3 ½	4 ½	4 ¾	4 ¾	4 ¾	4 ¾
Oil price (Brent, USD/barrel)	109	108	108	108	108	108	108

1. Values rounded to 1/4

Table 21: Contingent liabilities

% of GDP	2013
Public guarantees	19.4*
Of which: linked to the financial sector	1.8

* Year 2012

Glossary of German legislation mentioned in the text

English name	German name
Act on the Appointment of a Council of Experts on Economic Development	Gesetz über die Bildung eines Sachverständigenrates zur Begutachtung der gesamtwirtschaftlichen Entwicklung
Act to Promote Economic Stability and Growth	Gesetz zur Förderung der Stabilität und des Wachstums der Wirtschaft
Fiscal Compact Implementation Act	Gesetz zur innerstaatlichen Umsetzung des Fiskalvertrags
Act on Protection against Risks and on Planning the Reorganisation and Liquidation of Credit Institutions and Financial Groups	Gesetz zur Abschirmung von Risiken und zur Planung der Sanierung und Abwicklung von Kreditinstituten und Finanzgruppen
Basic Law	Grundgesetz
Budgetary Principles Act	Haushaltsgrundsätzegesetz
Renewable Energy Sources Act	Erneuerbare-Energien-Gesetz
Act on the Improvement of the Financial Structure and Quality of Statutory Health Insurance	Gesetz zur Weiterentwicklung der Finanzstruktur und Qualität in der gesetzlichen Krankenversicherung
Income Tax Act	Einkommensteuergesetz

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