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Delegations will find attached document SWD(2013) 601 final.

This document is aimed for discussion in the **Eurogroup.**

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COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of GERMANY

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of GERMANY

{C(2013) 8001 final}

COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of GERMANY

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COMMISSION OPINION

on the Draft Budgetary Plan of GERMANY

1. INTRODUCTION

Germany submitted its Draft Budgetary Plan for 2014 on 15 October 2013 in compliance with Regulation 5EU) No 473/2013 of the Two-Pack. The Draft Budgetary Plan was submitted by the outgoing federal government on the basis of unchanged policies. Germany is subject to the preventive arm of the Stability and Growth Pact and should preserve a sound fiscal position which ensures compliance with the medium term objective.

As the debt ratio was 80.0% of GDP in 2011 (the year in which Germany corrected its excessive deficit), exceeding the 60% of GDP reference value, during the three years following the correction of the excessive deficit Germany is subject to the transitional arrangements as regards compliance with the debt criterion. In this period it should ensure sufficient progress towards compliance.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2013 Autumn Forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission 2013 Autumn Forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2013 and 2014 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

In 2012 and early 2013, economic growth in Germany was significantly affected by the slowdown in global economic activity and the prevailing uncertainty caused by the debt crisis. GDP dropped abruptly in the final quarter 2012 and stagnated in the first quarter 2013, also due to exceptionally harsh weather, followed by weather-related catching up boosting GDP growth in the second quarter 2013. The macroeconomic scenario underlying the Draft Budgetary Plan, which was published in April (see Box 1), projects economic activity to reaccelerate along with the expected improvement to the external environment over the forecast horizon, leading real GDP to increase by 0.5% in 2013 and 1.6% in 2014. In both years, growth is expected to be mainly driven by domestic demand, with private consumption playing a key role on the back of robust labour market developments and rising wages. For 2014, solid consumption growth is projected to be accompanied by a strong growth contribution of gross fixed capital formation, given the expectation of equipment investment starting to recover in the course of 2013. The macroeconomic outlook underlying the Draft Budgetary Plan is broadly in line with the Stability Programme's macroeconomic scenario, with labour market developments being somewhat more optimistic. It is also broadly in line with the Commission 2013 Autumn Forecast as regards the pace and pattern of economic growth in 2013 and 2014, as well as with the Commission estimate of Germany's potential growth rate[1].

Table 1. Comparison of macroeconomic developments and forecasts

	2012	2013			2014		
	COM	**SP**	**DBP**	**COM**	**SP**	**DBP**	**COM**
Real GDP (% change)	0.7	0.4	0.5	0.5	1.6	1.6	1.7
Private consumption (% change)	0.8	0.6	0.6	0.9	1.0	1.0	1.4
Gross fixed capital formation (% change)	-2.1	0.5	-0.2	-0.9	4.1	4.1	4.4
Exports of goods and services (% change)	3.2	2.8	1.6	0.3	4.4	5.0	4.6
Imports of goods and services (% change)	1.4	3.5	2.2	1.0	4.5	5.3	5.7
Contributions to real GDP growth:							
- Final domestic demand	0.2	0.6	0.7	0.6	1.5	1.5	1.9
- Change in inventories	-0.5	0.0	0.0	0.2	0.0	0.0	0.0
- Net exports	1.0	-0.1	-0.2	-0.3	0.2	0.1	-0.2
Output gap[1]	0.0	-1.0	-0.7	-1.0	-0.8	-0.4	-0.7
Employment (% change)	1.1	0.0	0.5	0.5	0.2	0.3	0.5
Unemployment rate (%)[2]	5.5	5.4	5.1	5.4	5.1	4.8	5.3
Labour productivity (% change)	-0.4	0.4	0.0	-0.1	1.4	1.4	1.2
HICP inflation (%)	2.1	n.a.	n.a.	1.7	n.a.	n.a.	1.7
GDP deflator (% change)	1.5	1.8	1.7	2.2	1.7	1.7	1.7
Comp. of employees (per head, % change)	2.6	2.3	2.4	1.9	2.7	2.8	2.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	7.0	6.2	6.0	6.9	6.2	6.0	6.6

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

[2]COM Eurostat definition; SP and DBP ILO definition

Source :

Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.

Box 1: The macroeconomic forecast underpinning the budget in Germany

The federal budget and fiscal projections at the level of general government are based on the federal government's own macroeconomic forecast which, based on the information available to the Commission at this stage, is not formally endorsed by an independent body as defined in Regulation (EU) No. 473/2013. However, the preparation of the government's projections involves the independent Joint Economic Forecast (*Gemeinschaftsdiagnose*) issued twice a year by leading research institutes. The Joint Economic Forecast is not explicitly defined by law, but operates within the framework of research mandates awarded by the government

[1] The federal government's macroeconomic autumn projections, published after the submission of the draft budgetary plan, are more closely in line with the Commission estimate, also given that they share the same updated and partly revised database.

through a call for tenders. It has been conducted since 1950 and is considered to be of high quality, in particular thanks to the involvement of several research institutes and their mutual checking of data, assumptions and conclusions. The government adopts its own macroeconomic projections and is not obliged to publicly respond to the Joint Economic Forecast. Nevertheless, the Joint Economic Forecast attracts high media attention and serves as a benchmark for the government's forecast, and deviations from the Joint Economic Forecast are customarily explained in the monthly report of the Federal Ministry of Economics and Technology. Transparency is further increased by the comprehensive annual reports of the Council of Economic Experts (*Sachverständigenrat*), which are usually published in mid-November. Even though not directly involved in budget planning, the Council also prepares macroeconomic and fiscal projections and analyses the government's projections in its reports. The Council was created by law in 1963 and is a body of five independent academic policy advisers supported by about 20 research and office staff that enjoys a high reputation and attention in the public debate. The federal government is required by law to respond to the Council's annual report in parliament, which it does in its Annual Economic Report. Moreover, budget planning is supported by the reports of the Working Party on tax revenue forecasting, which are prepared twice a year in spring and autumn on the basis of the federal government's economic forecast. The Working Party is an independent advisory council to the Federal Ministry of Finance established by an administrative agreement and consisting of working-level representatives of the Federal Ministry of Finance, the Federal Ministry of Economic Affairs and Technology, five economic research institutes, the Federal Statistical Office, the *Bundesbank*, the German Council of Economic Experts, the finance ministries of the *Länder*, and the Federal Union of Central Associations of Local Authorities. The federal government adopts the tax revenue forecast of the Working Party as a basis for both the annual budget (since 1955) and the medium-term financial planning (since 1968). The Working Party's tax revenue forecasts are considered to be of high quality and attract significant media attention.

The submitted Draft Budgetary Plan is based on the spring issues of the government's macroeconomic projections and of the projections of the Working Party on tax revenue forecasting, published already in April and May. The usual publication dates of the autumn issues of the government's macroeconomic projections, the Joint Economic Forecast and the tax revenue projections are after the submission deadline for the Draft Budgetary Plan.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

Germany's Draft Budgetary Plan projects a balanced general government budget for 2013, which is a slight improvement compared to the Stability Programme's deficit target of ½% of GDP, also reflecting favourable outcomes in the first half of the year. The Draft Budgetary Plan confirms the Stability Programme's target of a balanced budget in 2014. For neither year significant changes in relation to the Stability Programme are planned in terms of overall revenue and expenditure ratios or individual revenue and expenditure categories. Moreover, the Draft Budgetary Plan foresees a slight improvement of 0.3 percentage points (pps.) in the (recalculated) structural balance[2] in 2013 and no change in 2014. The Draft Budgetary Plan's projections for both years are broadly in line with the Commission 2013 Autumn Forecast in

[2] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the draft budgetary plan, using the commonly agreed methodology.

terms of the headline budget balance and the structural balance as well as the composition of revenue and expenditure. However, the Draft Budgetary Plan was submitted by the outgoing federal government. Changes to the budgetary plans may therefore arise from the on-going formation of a new government.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2012	2013			2014			Change: 2012-2014
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**44.8**	**45.0**	**45**	**44.6**	**45.0**	**44½**	**44.5**	**n.a.**
of which:								
- Taxes on production and imports	11.2	11½	11	11.1	11	11	11.0	n.a.
- Current taxes on income, wealth, etc.	12.0	12½	12½	12.2	12½	12½	12.3	n.a.
- Capital taxes	0.2	0	0	0.2	0	0	0.2	-0.2
- Social contributions	16.8	17	16½	16.6	16½	16½	16.4	n.a.
- Other (residual)	4.6	n.a.	n.a.	4.6	n.a.	n.a.	4.7	n.a.
Expenditure	**44.7**	**45½**	**45**	**44.7**	**44½**	**44½**	**44.5**	**n.a.**
of which:								
- Primary expenditure	42.3	43	42½	42.4	42	42	42.3	n.a.
of which:								
Compensation of employees	7.6	7½	7½	7.6	7½	7½	7.6	n.a.
Intermediate consumption	4.9	5	5	5.1	5	5	5.1	0.1
Social payments	24.1	24½	24½	24.1	24½	24	24.0	-0.1
Subsidies	0.9	1	1	1.0	1.0	1	0.9	0.1
Gross fixed capital formation	1.5	1½	1½	1.5	1½	1½	1.5	n.a.
Other (residual)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Interest expenditure	2.4	2½	2½	2.3	2½	2	2.2	-0.4
General government balance (GGB)	**0.1**	**-½**	**-0**	**0.0**	**0**	**0**	**0.1**	**-0.1**
Primary balance	**2.5**	**2.0**	**2½**	**2.3**	**2½**	**2½**	**2.2**	**n.a.**
One-off and other temporary measures	-0.1	-0	-0	0.0	-0	-0	0.0	0.1
GGB excl. one-offs	**0.2**	**-½**	**-0**	**0.0**	**0**	**0**	**0.1**	**-0.2**
Output gap[1]	0.0	-1.0	-0.7	-1.0	-0.8	-0.4	-0.7	-0.4
Cyclically-adjusted balance[1]	0.1	0.3	0.4	0.5	0.7	0.4	0.5	0.3
Structural balance (SB)[2]	**0.2**	**0.3**	**0.4**	**0.5**	**0.7**	**0.4**	**0.5**	**0.2**
Change in SB	*1.3*	*0.0*	*0.3*	*0.3*	*0.4*	*0.0*	*0.0*	-
Two year average change in SB	*1.3*	*0.6*	*0.8*	*0.8*	*0.2*	*0.2*	*0.1*	-
Structural primary balance[2]	2.6	2.7	2.7	2.8	3.0	2.6	2.7	0.0
Change in structural primary balance		*-0.1*	*0.2*	*0.2*	*0.3*	*-0.1*	*-0.2*	-
Expenditure benchmark								
Applicable reference rate[3]	0.01	1.16	1.16	1.16	1.08	1.08	1.08	-
Deviation[4] (% GDP)	-0.1	0.2	0.0	0.1	-0.8	-0.3	0.1	-
Two-year average deviation (% GDP)	-0.6	-0.4	0.0	0.0	-0.3	-0.2	0.1	-

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

[3] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A lower rate applies as long as the country is adjusting towards its MTO, including in year t.The reference rates applicable to 2014 onwards have been updated in 2013.

[4] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A positive sign implies that expenditure growth exceeds the applicable reference rate.

Source:

Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.

3.2. Debt developments

The debt-to-GDP ratio increased by 1.1 pps. to 81% of GDP in 2012 due to the euro area and financial sector stabilisation measures. The Draft Budgetary Plan projects a diminishing debt-to-GDP ratio in 2013 and 2014 thanks to the balanced budget, the denominator effect of GDP growth and the on-going winding up of "bad banks". This is in line with the Stability Programme, if the base effect of the downward revision of the 2012 debt-to-GDP ratio is taken into account. The Draft Budgetary Plan's debt projections are also broadly in line with the Commission 2013 Autumn Forecast, which however does not factor in potential gains from the winding up of "bad banks".

Table 3. Debt developments

(% of GDP)	2012	2013			2014		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**81.0**	**80½**	**79½**	**79.6**	**77½**	**77**	**77.1**
Change in the ratio	1.1	-0.6	-1 1/2	-1.5	-2.7	-2 1/2	-2.5
Contributions[2] :							
1. Primary balance	**-2.5**	**-2**	**-2 1/2**	**-2.3**	**-2 1/2**	**-2 1/2**	**-2.2**
2. "Snow-ball" effect	**0.7**	**0.6**	**0.6**	**0.2**	**-0.2**	**-0.4**	**-0.5**
Of which:							
Interest expenditure	2.4	2 1/2	2 1/2	2.3	2 1/2	2	2.2
Growth effect	-0.5	-0.3	-0.4	-0.4	-1.2	-1.2	-1.3
Inflation effect	-1.1	-1.5	-1.3	-1.7	-1.3	-1.3	-1.3
3. Stock-flow adjustment	**2.8**	**1**	**1/2**	**0.6**	**0**	**0**	**0.3**
Of which:							
Cash/accruals difference		n.a.	n.a.		n.a.	n.a.	
Net accumulation of financial		n.a.	n.a.		n.a.	n.a.	
of which privatisation proceeds		n.a.	n.a.		n.a	n.a.	
Valuation effect & residual		n.a.	n.a.		n.a.	n.a.	

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Stability programme (SP); Draft Budgetary Plan (DBP); Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.

3.3. Measures underpinning the Draft Budgetary Plan

The Draft Budgetary Plan includes no new discretionary measures for 2014. The only discretionary measure mentioned in the Draft Budgetary Plan is an aid and reconstruction fund that was set up in July 2013 in response to the flood disaster. The fund amounts to EUR 8 billion and is planned to be disbursed over four years[3]. Furthermore, the projections factor in another reduction in the pension contribution rate in 2014, which results from applying a semi-automatic rule mandated by law and reflects the pension insurance scheme's currently favourable financial situation. No significant one-off measures are foreseen in 2013 and 2014. Additional measures of relevance for the 2014 budget may result from the formation of a new federal government.

[3] Using fractions rounded to ½% of GDP, the Draft Budgetary Plan reports an annual budgetary impact of the fund of 0% of GDP over the period 2013 to 2016.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Germany is subject to the preventive arm of the Stability and Growth Pact. The general government bugdet deficit was below 3% of GDP in 2012 and is planned to remain so in 2013 and 2014, which is confirmed by the Commission 2013 Autumn Forecast.

Germany is in a transition period as regards the debt criterion, which means that it is required to make sufficient progress towards compliance with the criterion and comply with the debt benchmark at the end of the transition period as from 2014. Based on the Commission 2013 Autumn Forecast, Germany is making sufficient progress towards compliance with the debt criterion in 2013 and the debt benchmark will be met at the end of the transition period.

Box 2. Council recommendations addressed to Germany

On 9 July 2013, the Council addressed recommendations to Germany in the context of the European Semester. In particular, in the area of public finances the Council recommended to Germany to preserve a sound fiscal position as envisaged which ensures compliance with the medium-term objective 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; improve the efficiency of the tax system, in particular by broadening the VAT base and by reassessing the municipal real estate tax base; use the available scope for increased and more efficient growth-enhancing spending on education and research at all levels of government; 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; reduce high taxes and social security contributions, especially for low-wage earners; and remove disincentives for second earners.

Germany registered a structural surplus of 0.2% of GDP in 2012 and thus complied with its medium-term objective of a structural deficit not exceeding 0.5% of GDP. According to the information provided in the Draft Budgetary Plan, Germany is expected to continue to comply with its medium-term objective in 2013 and 2014, which is confirmed by the Commission 2013 Autumn Forecast.

Table 4. Compliance with the debt criterion

	2012	2013	2014
		COM[1]	COM[1]
Gap to the debt benchmark [2,3]	n.r.	n.r.	-3.8
Structural adjustment [4]	1.3	0.3	n.r.
To be compared to:			
Required adjustment [5]	-0.1	-1.1	n.r.

Notes:

[1] Assessment of the consolidation path according to 2013 COM Autumn Forecast and assuming growth follows COM projections.

[2] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[3] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[4] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[5] Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM budgetary projections for the previous years are achieved.

Source :

Commission services' 2013 Autumn Forecast (COM); Commission services' calculations.

5. SUMMARY

Germany runs a balanced budget and, according to the Commission 2013 Autumn Forecast, is making sufficient progress towards compliance with the debt criterion in 2013, and it will meet the debt benchmark at the end of the transition period in 2014. Germany complied with its medium-term objective in 2012 and will continue to do so in 2013 and 2014. The federal budget and fiscal projections at the level of general government are based on the federal government's own macroeconomic forecast which, based on the information available to the Commission at this stage, is not formally endorsed by an independent body. However, the independent Joint Economic Forecast of leading research institutes is used as a benchmark for the government forecast. The Draft Budgetary Plan for 2014 is based on the spring issue of the government's macroeconomic forecast, which was published already in April. Furthermore, Germany's Draft Budgetary Plan does not address the Council recommendations issued in the context of the European Semester with respect to enhancing the cost-effectiveness of public spending on healthcare and long-term care, improving the efficiency of the tax system, using the available scope for increased and more efficient spending on education and research, completing the implementation of the constitutional balanced-budget rule at *Länder* level, reducing high taxes and social security contributions especially for low-wage earners and removing disincentives for second earners.