Federal Ministry of Finance

Fiscal and Economic Policy

# German Stability Programme

## January 2010 Update

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## Foreword

In accordance with the provisions of the Stability and Growth Pact, the Member States which have adopted the euro are obliged to submit each year an updated stability programme to the ECOFIN Council. The Programme follows the format and content guidelines specified in the guidelines on the form and content of stability and convergence programmes (Code of Conduct).

This update of the German Stability Programme was approved by the German Federal

Cabinet on 9 February 2010. Each update of the German Stability Programme and the corresponding recommendation for a statement by the Council on the updated German Stability Programme are submitted by the federal government to the competent committees of experts of the German Bundestag and Bundesrat.

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

# 1 Summary


- During the last quarter of 2008 and the first quarter of 2009, Germany experienced a sharp economic downturn, the effects of the global economic and financial crisis being felt especially acutely in the particularly export-oriented manufacturing sector. In 2009, economic performance was down on yearly average by 5.0% in real terms compared to the previous year, despite the economic recovery over the course of the year. The federal government's annual forecast predicts real GDP growth in 2010 of 1.4%.
- The comprehensive measures undertaken to support the financial markets and the economy have made a marked contribution towards stabilising the economic situation and improving the long-term perspectives for growth in Germany. Nevertheless, the measures introduced to tackle the crisis together with the effects of the automatic stabilisers have left a deep mark on Germany's public budgets. The general government budget balance worsened in 2009 to -3.2% of GDP, the deficit will rise further this year to 5½% of GDP.
- On 2 December 2009, the ECOFIN Council decided that Germany is running an excessive deficit and issued recommendations on how this should be reduced. The recommendations set 2011 as the year in which Germany should begin consolidation, and call for an average annual reduction in the structural deficit of at least 0.5% of GDP. The German deficit is to be reduced once again to below the reference value of 3% of GDP by 2013.
- Germany will meet the recommendations of the ECOFIN Council. The new constitutional budget rule provides an institutional guarantee for the policy of consolidation which is indispensable in attaining this target. In the Financial Planning Council, both the Federation and the *Länder* declared their joint intention to noticeably strengthen their future consolidation efforts. The federal government will take care to ensure that the necessary consolidation measures taken are in line with a design of public finances conducive to growth.

## 2 Excessive deficit procedure in relation to Germany

On 30 September 2009, as part of European budgetary surveillance, the German government reported a provisional general government budget balance of -3.7% of GDP for 2009 to the European Commission. The Commission's autumn forecast of 3 November 2009 assumed a deficit for 2009 amounting to 3.4% of GDP. This represents an abrupt and equally grave deterioration compared to the balanced general government budget of 2008. This development is largely the result of the decision taken in light of the current financial and economic crisis to allow the automatic stabilizers to take full effect and to support economic activity by introducing a package of measures as part of the European Economic Recovery Programme.

The predicted overrun of the Maastricht deficit reference value of 3% of GDP led to the initiation of an excessive deficit procedure in relation to Germany in line with the relevant provisions of the Treaty on the functioning of the European Union (TFEU) and of the Stability and Growth Pact. At present, together with Germany, 20 of the 27 Member States of the European Union find themselves the subject of excessive deficit measures. This gives an indication of the extent to which the Stability and Growth Pact is currently being tested. From a German point of view, the Pact is an indispensable mainstay for a stable and successful European economic and monetary union. It is the duty of every Member State to make a credible effort to ensure that the Pact passes this test.

On 20 October 2009, the ECOFIN Council adopted conclusions providing for a coordinated exit strategy under the Stability and Growth Pact with respect to the packages introduced to stimulate the economy. This strategy is to be accompanied by an improvement in national budgetary frameworks, measures to strengthen fiscal sustainability and structural reforms to enhance economic growth.

On 2 December 2009, in line with Article 126 of the TFEU, the ECOFIN Council determined that Germany is running an excessive deficit and issued recommendations to reduce this deficit. In doing so, the Council took into account the special circumstances as a result of the financial and economic crisis and the coordinated response within the context of the European Economic Recovery Programme. Germany was called upon to implement the measures foreseen in this context in 2010 as planned. The recommendations provide for 2011 as the year in which Germany should begin consolidation, and calls for an average annual reduction in the structural deficit of at least 0.5% of GDP. The German deficit is to return to under the reference value by 2013. Germany has until 2 June 2010 to show how it intends to meet the recommendations.

It is generally agreed that the measures introduced to stimulate the economy and boost growth were both necessary and effective. However, responsible fiscal policy cannot allow this to become a permanent burden on the public budgets. Consolidating the public finances is the central task of fiscal policy over the coming years. Germany continues to pursue its medium-term objective of a structural government budget close to balance. The new constitutional budget rule ensures this goal and provides an institutional guarantee for the policy of consolidation which is indispensable in reaching this goal.

# 3 Fiscal policy in Germany: the quality and sustainability of public finances

Sound public finances present governments with a certain amount of room for manoeuvre – including with respect to future generations – and are a necessary precondition for confidence in a state capable of acting and long-term favourable conditions for growth and employment. But this is not a one-way street – economic growth and increased employment create the best conditions for sustainable public finances.

## *3.1 The quality of public finances*

Discussions on the quality of public finances are aimed at increasing growth potential by designing state spending and revenue in a manner which will continue to support growth for many years. This includes strengthening growth potential by deploying public money in as efficient and growth-oriented a manner as possible on the expenditure side and by relieving the burden on citizens and industry by taxes and other fiscal charges. Quantitative and qualitative consolidation act as complements to each other. Public budgets built on sound finances are a decisive precondition if there is to be increased emphasis on areas geared towards the future. Fiscal policy rules and institutions which, for example, ensure a stronger focus on results in the budgeting process also have an important role to play.

### *Quality of expenditure*

Education and research provide a foundation for increasing growth potential. An education policy which creates opportunities for advancement ensures long-term social cohesion, protects against unemployment and increases productivity. Innovation enhances prosperity through more growth and employment while at the same time serving to solve global challenges. Both the Federation and the *Länder* thus increased spending on education and research over the past years. The Federation alone is planning to increase spending in this area between 2010 and 2013 by a further €12bn. The *Länder* and the private sector must also make their contributions in order to ensure that total spending on education and research reaches 10% of GDP by 2015. Furthermore, the funds available must be deployed in an efficient manner within a framework conducive to innovation.

The comprehensive packages of measures introduced to prop up the financial markets and the economy have made a marked contribution towards stabilising the economic situation and towards improving long-term growth perspectives in Germany. The total extent of the measures (revenue and expenditure) surpasses €100bn. In addition, the automatic stabilizers are in full effect.

The additional investment activity of the Federation and the *Länder* allows jobs to be retained and strengthens the foundations for growth by improving the education infrastructure. These investments are being made with special attention given to climate protection and energy efficiency. The crisis has seen increased spending on the job market, for example on better conditions for short-time working or on the worker qualification campaign and on reducing contributions to unemployment insurance. Moreover, in 2010 the government will use budget funds to ease pressures caused by the crisis on unemployment insurance and statutory health insurance, in order to keep social security contributions – which are paid in equal parts by employee and employer – below 40% in 2010 (see Chapter 3.2). The financial market crisis has made it harder for companies to find financing. Small and medium-sized enterprises in particular are dependent upon functioning credit financing. The German Business

Fund (*Wirtschaftsfonds Deutschland*) has introduced instruments tailored to meet the needs of SME's in particular.

The investment expenditure contained in particular in the second economic package of measures have been bundled with own credit authorisations in the Investment and Repayment Fund (*Investitions- und Tilgungsfonds*). Its debts will be repaid in future years with part of the Bundesbank profits. The financial market stabilization fund (*Finanzmarktstabilisierungsfonds*, or "SoFFin"), provides indispensable stability to the financial market. This fund is equipped with authorisations to assume guarantees amounting to €400bn and with credit authorizations for recapitalisation measures and the assumption of risks amounting to €80 bn. The SoFFin can provide stabilisation measures until the end of 2010, subject to state aid approval by the European Commission. Thereafter, the fund is to be wound up and dissolved. Once the fund has been wound up, the Federation will assume 65% of the costs, with the *Länder* taking up the remaining 35%. To date, no losses have been made by the Federation. The stabilisation measures of the fund are being suitable recompensed. The costs incurred in 2009 by the Financial Market Stabilisation Agency (*Bundesanstalt für Finanzmarktstabilisierung*, or FMSA) for administering the SoFFin were covered in full by the FMSA's application fees.

A further aspect supporting the quality of public finances is a subsidy policy which systematically assesses (expenditure-side) financial assistance and (revenue-side) tax privileges on the basis of macroeconomic costs and benefits. A comprehensive analysis of all subsidies increases the pressure to justify these selective measures and thus contributes to the dismantling of financial assistance and tax privileges over the medium-term, a development which makes sense from both an economic and a fiscal policy perspective.

The measures introduced to tackle the crisis and the effects of the automatic stabilisers have together left deep marks in Germany's public budgets. In the Financial Planning Council, both the Federation and the *Länder* declared their joint intention to strengthen their consolidation efforts substantially in the future. The federal government will take care to include the necessary consolidation steps in drafting the 2011 federal budget and the financial plan until 2014. To this end, the coalition agreement states that all duties assumed by the state must be examined with respect to their necessity and that all areas of expenditure must make a contribution to consolidation. The federal government will take care to ensure that the necessary consolidation is in line with a growth-friendly design of public finances.

### *Quality of revenue*

Tax policy will have to strike a balance between two goals in the coming years. Firstly, it must ensure that the tasks of the state are financed and, secondly, it must mobilize the forces for growth. As a result, the federal government plans to simplify and modernise the tax system to a noticeable extent and, in this context, to relieve the burden on citizens and industry on a durable basis. Tax policy which seeks to take the economic situation into account and promote growth has to reduce the burden on companies and private households in times of economic crisis in order to lay the foundations for more consumption and investment. It was with this in mind that the federal government introduced the Act to Accelerate Economic Growth (*Wachstumsbeschleunigungsgesetz*) on 1 January 2010, relieving the burden on families by introducing a significant increase in the respective amounts of child benefit and tax-free child allowance – for the second time within one year.

The economic recovery packages alone reduced the burden from income tax considerably, both by raising the basic personal allowance by €170 on 1 January 2009 and 1 January 2010, respectively, and by reducing the initial tax rate from 1 January 2009 from 15 % to 14 %. Moreover, the benchmark figures of pay scales were "shifted to the right", again in two steps. These measures reduce the burden on citizens considerably, in 2009 to the amount of approximately €3.1bn, in 2010 by around €5.8bn. Low-earners in particular benefit, and there are greater incentives for the hitherto unemployed to take up work. The Act to improve the tax treatment of expenditure on old-age provisions, also known as the Citizens' Relief Act (*Gesetz zur verbesserten steuerlichen Berücksichtigung von Vorsorgeaufwendungen*, or *Bürgerentlastungsgesetz*), means that, from 2010, citizens will have roughly €10bn more from their wages and income.

The federal government is also creating additional investment incentives within company taxation. 2009 already saw the entry into force of measures leading to the burden on companies being reduced by slightly more than €2.5bn in total. Furthermore, the Act to Accelerate Economic Growth provides for the following further measures in particular:

- Long-term application of the higher tax threshold of €3m with regard to the interest barrier (*Zinsschranke*) and making the escape clause more flexible for corporations.
- Changes to the payroll clause (*Lohnsummenklausel*) and the asset retention period (*Behaltenszeitraum*) for companies with respect to gift and inheritance tax.
- Reducing the rate of VAT to seven percent with respect to the provision of accommodation.
- Continuing the restructuring clause (*Sanierungsklausel*) with regard to corporation tax.
- Improving the conditions for deducting losses.
- Immediate write-off of low value economic goods.

Taken together with the tax measures which were already agreed during the previous legislature, citizens and companies can expect relief amounting to over €24bn from 2010 on. The federal government will further strengthen the motivation and commitment of all citizens by creating more financial freedom. It will reduce bureaucratic burdens and push for a more simple taxation system with lower tax rates. It will seek as a matter of priority to relief the burden on the low and middle-income earners, while flattening the "mid-scale bulge" by changing the income tax schedule to a system of staggered progression. The number and scope of the tax bands in this system will be developed with this goal in mind. The new schedule is as far as possible to enter into effect on 1 January 2011, taking both economic developments including their effects on the perspectives for the public budgets, and structural savings into account, in order to create the necessary leeway in line with the budget rules set out under European and constitutional law.

### *Institutional framework conditions*

The institutional framework conditions are often cited as an essential factor in ensuring the attainment of sustainable public budgets and a high quality of public finances, as witnessed by the conclusions of the ECOFIN Council of 20 October 2009. Following the entry into force of the first step of federalism reform in 2006, which streamlines competencies for example, constitutional rules limiting the uptake of credit were introduced jointly for the Federation and for the *Länder* as a central measure in the second stage of federalism reform. The new budget rule came into effect in August 2009 and will be applied from the 2011 budget year on. The reform of the rules for the Federation is similar to the concept of the European Stability and Growth Pact and contains the following central elements:

- The principal of at least almost structurally balanced budgets.
- The effects of cyclical fluctuations on the public budgets are taken into account symmetrically over the entire business cycle.
- Exceptions are provided for extreme situations, they can be availed of only in connection with a corresponding repayment plan.
- Rules enforced by way of a control account when executing the budget at federal level.

Against the background of the financial and economic crisis, rules for a transitional period up to 2015 (for the Federation) and 2019 (for the *Länder*) were agreed. The Federation is obliged to reduce the structural deficit existing in 2010 in steps of equal magnitude to under the threshold of 0.35%, which will apply from 2016. The *Länder* are no longer permitted to incur structural debt from 2020 onwards.

Closely coupled with the new constitutional budget rule is the introduction of a Federation-wide early warning system to prevent budgetary emergency situations. To this end, a stability council has been established which will start work in 2010 and monitor developments in the federal and regional budgets. In addition, it will continue the work of the Financial Planning Council, effectively acting as its replacement. This work includes the intrastate application of obligations of the Federal Republic of Germany arising from the European Stability and Growth Pact.

As part of the "golden rules" of fiscal policy contained in the coalition agreement, it was determined among other things that in drawing up the budget important reference values would be prescribed on a binding basis by the federal cabinet. In addition, policy goals are to be more focussed than hitherto on qualitative rather than quantitative requirements. The tasks entrusted to the state and the expenditure employed to meet these tasks are not only to be regularly assessed with regard to their necessity, their effectiveness and efficiency must also be examined. The financial implications of budget policy decisions are to be rendered more transparent by setting out and recording the resources used in effecting them. In order to ensure that the budgetary process is oriented more towards results and resource consumption, a project to modernise the system of budgeting and accounting at federal level (MRH Project) was established at the Federal Ministry of Finance as early as 2006. The project group publicly presented the reform concept in June 2009. At its core is a cash-based accounting system of output-based budgeting showing resource consumption and relevant indicators. The data is generated and compiled on the basis of financial bookkeeping and comprehensive cost accounting. The data relating to resources allows a complete account of federal property to be drawn up. The concept is being tested until 2013 as part of a pilot phase involving three federal ministries.

### *Main reforms to boost the momentum for growth*

In addition to the measures with respect to public finances, further reforms are helping to bolster growth potential. The federal government will for example improve the conditions for entrepreneurial spirit by strengthening competition on the markets, reducing the administrative burden on companies and supporting these in their activities on the global markets. With its programme covering bureaucracy reduction and better legislation, the federal government has promised to reduce by a net amount of 25% the administrative burden stemming from reporting requirements by 2011 (compared to 2006). Insolvency rules are to be reformed and focused more on the early restructuring and reorganisation of companies.

With a view to further improving the conditions for competition, the federal government will amend the Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*, GWB). As a first step, it will introduce into the GWB the possibility of unbundling as a last resort in order to complete the powers of the anti-trust authorities. The second step will be to further develop the GWB in order to accentuate the basic aim and purpose of a modern, dynamic set of competition laws and to render the implementation of such more efficient. Moreover, the federal government plans to reform and streamline provisions governing public procurement. The goal is a more open, transparent and fair competition in awarding public contracts.

The federal government will submit by autumn 2010 an energy concept containing scenario-based guidelines for the clean, reliable and affordable supply of energy. In addition, it will present a new energy research programme which will focus on areas of importance for the future, such as energy efficiency and storage technologies, renewable energy, intelligent networks, and second generation biofuels. Renewables have to be made marketable and storable so that they can provide the main source of energy in the long-term. Until then, nuclear energy will remain an important part of a balanced energy mix. In 2010, the federal government will review the measures agreed in its "integrated energy and climate package" with respect to their effectiveness and cost-efficiency and, where necessary, make further adjustments. In order to step up competition on the German gas market, it will amend the Gas Network Ordinance (*Gasnetzzugangsverordnung*) and improve access to existing capacities in the gas distribution system.

With a view to ensuring an effective and efficient labour market policy over the long-term, labour market instruments are to be examined and their number reduced considerably. It will be made easier to conclude fixed-term employment contracts. Amendments to the rules on the additional earnings for those receiving basic income benefits will also be assessed. The goal is to increase incentives to take up work subject to full social insurance contributions and to relieve the burden on the public budgets. Furthermore, a better work-life balance is to be ensured, in particular by enhancing daytime care for children under three years of age.

A range of measures aimed at stabilising the financial system on a sustainable basis have already either been implemented or provided for. In future, regulation is to be broadened to such an extent that all financial institutes, products and markets are to be subject to appropriate supervision, banks and securities companies are to reach a sufficient degree of equity capitalization and excessive risk-taking is to be prevented. The federal government will improve banking supervision in Germany by centralizing it in future at the Deutsche Bundesbank. In addition, legal measures are planned in order to ensure financial market stability even in times of crisis at large credit institutes. In December 2009, the Federal Financial Supervision Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, or Ba-Fin) tightened the rules relating to payments in banks and insurances companies.

The rail reform started in 1994 with the state retaining responsibility for infrastructure and Deutsche Bahn AG being organisation under private-sector law is being continued. As soon as the capital markets permit, steps will be initiated to gradually privatise the transport and logistics divisions in a manner designed to optimise return. The infrastructure divisions will not be privatised as these are part of the state's responsibility for infrastructure. The provisions of the General Railways Act (*Allgemeines Eisenbahngesetz*) relating to regulation will be amended to improve rail competition.

At the global level, the federal government is actively involved in ensuring a sustainable process of growth. The federal government will implement the resolutions made at recent G8 and G20 summits – such as with regard to the regulation of international financial markets – in a responsible manner and, where necessary, support their implantation within the context of the EU or other forums. In addition, the federal government is pushing within the G20 for an internationally coordinated exit from the measures taken to promote the economy and stabilize the financial markets. Moreover, the federal government is cooperating with the other G20 member states to implement the framework for strong, sustainable and balanced growth agreed at the G20 summit in Pittsburgh. In order to be able to address the danger of future crises through suitable international regulations, the G20 in Pittsburgh supported the German initiative for a Charter for Sustainable Economic Activity. The federal government will continue to work within the G20 to ensure that this Charter progresses in a targeted manner.

### *3.2 The long-term sustainability of public finances*

Changes in the structure and size of the population represent an enormous challenge to the long-term sustainability of public finances. At both national and EU level, long-term budget projections with respect to population trends are drawn up at regular intervals covering several years. In summer 2009, the results of the joint work of the European Commission and the Member States were published (Ageing Report 2009) and adopted by the ECOFIN Council.

The population forecasts for Germany assume low rates of birth and a continued increase in life expectancy. The share of people of working age (15 to 64 years of age) in the overall population is sinking, while the share of those 65 or over continues to grow. The result is a considerable increase in the old-age dependency ratio. Whereas in 2007 there were 30 people aged 65 or over for every 100 people of working age in Germany, this figure is expected to have doubled by 2060. The decline in the numbers of people of working age reduces the number of people available to the job market. This trend is counteracted by the increase in participation rates. The forecasts predict an increase in labour market participation of 15 to 64 year olds from roughly 76% in 2007 to 80% in 2020, this rate then persisting until the end of the period being forecast. This is due in part to efforts of the federal government to limit early retirement, improved qualification opportunities for older workers (lifelong learning) and improvements in job offers for older workers. The gradual increase of the retirement age to 67 also leads over the period being forecast to a significant increase in the participation rate of 65 to 71 year olds from just below 7% in 2007 to almost 24% in 2050.

The increasing proportion of the population over 65 years of age leads to an increase in expenditure on old-age provisions from 10.4% of GDP in 2007 to 12.8% in 2060. This increase is slowed down by the measures mentioned above to increase labour market participation, by the introduction of a sustainability factor in adjusting old-age pensions and by the increase in the regular retirement age. In addition, revenue from contributions is forecast to rise from 7.2% of GDP in 2007 to 8.6% in 2060. The difference between revenue and expenditure is therefore forecast to increase slightly over this period by 1% of GDP. This increase is largely the result of rising expenditure on civil-servant pensions, which are not counter-financed by contributions.

In addition to the process of society ageing, the health of the population and the developments in the cost structure in the health sector are important factors influencing health spending. Several variations on the developments in health expenditure were calculated for the purposes of the forecast, with a middle variation been chosen, according to which health spending between 2007 and 2060 is expected to grow (as a proportion of GDP) by 1.4 percentage points. Moreover, the forecast assumes an increase in spending on long-term care of 1.5 percentage points of GDP.

Expenditure on education is forecast to fall slightly from 3.9% of GDP in 2007 to 3.5% in 2060. This figure does not take into account the efforts of the Federation and the *Länder* to increase participation in education and to attain higher standards of education. In addition, the Federation and the *Länder* agreed at the education summit in October 2008 to increase the share of public and private spending on education and research to 10% of GDP by 2015 (see Chapter 3.1).

Spending on unemployment insurance will fall only in the first decade of the period forecast, dropping from 0.9% of GDP to 0.6%, where it will persist until the end of the forecasted period. This figure is based on the assumption that structural unemployment will remain unchanged at a relatively high level in the long-run. In contrast, the *Rürup* Commission for example assumed in its calculations that there would be a clear drop in the number of unemployed in the long-run as a result of a reduced supply of the factor labour.

Demographic change will elevate age-dependent spending over the course of the projected period to a much higher level than in the year of departure. Over the past years, Germany has already seen considerable efforts being undertaken to limit the effects of demographic change on the sustainability of public finances. This course will have to be maintained in the years to come.

**Table 1: Government expenditure in Germany from a long-term perspective**

| | 2007 | 2015 | 2020 | 2030 | 2040 | 2050 | 2060 |
|---|---|---|---|---|---|---|---|
| | Expenditure as a % of GDP | | | | | | |
| Old-age provision[1] | 10.4 | 10.1 | 10.5 | 11.5 | 12.1 | 12.3 | 12.8 |
| pm: Revenue from contributions[2] | 7.2 | 6.7 | 6.9 | 7.8 | 8.3 | 8.4 | 8.6 |
| Expenditure on health [3] | 7.4 | 7.9 | 8.1 | 8.5 | 9.0 | 9.2 | 9.2 |
| Expenditure on long-term care[4] | 0.9 | 1.1 | 1.2 | 1.4 | 1.8 | 2.2 | 2.4 |
| Expenditure on education[5] | 3.9 | 3.4 | 3.2 | 3.3 | 3.4 | 3.4 | 3.5 |
| Unemployment insurance[6] | 0.9 | 0.8 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| | Assumptions | | | | | | |
| Increase in productivity in % | 1.5 | 1.6 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 |
| GDP growth in % | 0.9 | 1.9 | 1.5 | 1.3 | 1.1 | 1.0 | 1.0 |
| Population between 15 and 64 in % | 66.3 | 65.9 | 64.6 | 59.7 | 56.7 | 56.2 | 55.0 |
| Labour participation (15 to 64) in % | 76.2 | 78.7 | 79.1 | 79.3 | 80.2 | 79.7 | 79.8 |
| Labour participation (55 to 64) in % | 57.3 | 67.6 | 69.9 | 70.5 | 74.7 | 73.9 | 73.9 |
| Labour participation (65 to 71) in % | 6.5 | 10.1 | 14.5 | 19.1 | 21.9 | 23.8 | 22.9 |
| Unemployment rate | 8.4 | 7.1 | 6.2 | 6.2 | 6.2 | 6.2 | 6.2 |
| Old-age dependency ration | 29.9 | 32.2 | 35.3 | 46.2 | 54.7 | 56.4 | 59.1 |
| Total population (millions) | 82.3 | 81.9 | 81.5 | 80.2 | 77.8 | 74.5 | 70.8 |
| Population over 65 and above (millions) | 16.3 | 17.4 | 18.6 | 22.1 | 24.2 | 23.6 | 23.0 |

Sources: EU Economic Policy Committee (EPC) and European Commission (Ageing Report 2009)
European Commission (Sustainability Report 2009)

[1] Statutory pension insurance and civil service pensions, [2] Statutory pension insurance, [3] Public health expenditure, [4] Statutory long-term care insurance and care support in the context of social benefits. The assumed dynamic development of care payments to the amount of the increase in GDP/persons employed does not correspond to current legislation. Under current legislation, and assuming a medium-term development in payments corresponding to the general inflation rate, the Ageing Report forecasts a maximum increase to 1.1% of GDP in 2050, [5] Excluding education expenditure by the Federal Labour Agency, [6] Substitute wage payments

### *Reforms in the social security systems*

The contribution rate to statutory health insurance was reduced as part of the 2nd package of economic measures on 1 July 2009 by 0.6 percentage points in order to ease the burden on both employers and employees and thus help to overcome the crisis. This was made possible by an increase in the federal transfer. Moreover, the Act to Stabilise the Social Security System (*Sozialversicherungs-Stabilisierungsgesetz*) contains a short-term measure allowing revenue shortfalls in the statutory health insurance funds as a result of the crisis to be compensated for by budget funds. To this end, the Health Fund will receive a one-off additional federal transfer amounting to €3.9bn under the draft bill in 2010 in addition to the general federal transfer of €11.8bn to compensate for expenditure relating to society as a whole. Thus, the health insurance funds will receive tax revenues amounting to €15.7bn in total this year. The general federal transfer to compensate for expenditure relating to society as a whole will be €13.3bn in 2011. At the same time, unnecessary costs are to be avoided in the health sector. The federal government will strengthen the competition within the health sector for innovative and efficient solutions by improving the framework conditions.

All people in need will continue to enjoy, irrespective of income, age, social background or health risk, high-quality medical care close to home. The structure, organisation and financing of statutory health insurance will be adapted to reflect demographic change and the latest developments in medicine. The system of financing statutory health insurance is to be transformed over the long-term into a system with more autonomy with respect to contributions, more leeway for regional differentiation, and employee contributions which are independent of income and which can be compensated for through social transfers. With a view to decoupling health costs and non-wage labour costs, employer contributions to statutory health insurance are to remain fixed. The federal government will establish a government commission in March 2010 to draw up proposals for a sustainable and socially balanced system of financing health care.

The Long-term Care Enhancement Act (*Pflege-Weiterentwicklungsgesetz*), which entered into force on 1 July 2008, has strengthened the provision of care in the home. The trend towards an increase in institutional care reflected over previous years did not continue in 2009. The social insurance system for long-term care is in relatively good shape, returning a surplus in 2009 of just under €1bn. Nevertheless, long-term care insurance was not immune to the current economic crisis, returning revenue shortfalls compared to earlier forecasts. However, the 2008 increase of 0.25 percentage points in the contribution rate to 1.95% should be enough to finance the improvements agreed until around spring 2013.

The goal of the federal government is to continue to improve long-term care insurance and the provision of long-term care so that dignified care of high standard is guaranteed into the future. To this end, in addition to a sustainable system of financing long-term care insurance, a sufficient number of adequately qualified care professionals and a future-proof provision and supply structure are required. With respect to the future design of long-term care insurance financing, the federal government will establish an inter-departmental working group charged with drawing up the necessary steps for additional capital cover in social insurance for long-term care. Changes to the system of financing allow services to be dynamised over the long-term. The definition of care dependency is to be amended, also with a view to improving the situation of those with restricted abilities for the routines of day-to-day life, e.g. persons with dementia.

Reforms on the labour market were continued at the beginning of 2009 with the introduction of the Act on the Reorganisation of Labour Market Policy Instruments (*Gesetz zur Neuausrichtung der arbeitsmarktpolitischen Instrumente*), which aims in particular at helping jobseekers to integrate more quickly into the labour market. The contribution rate to unemployment insurance was again reduced from 1 January 2009, and fixed by law at 3.0 percent. It was then lowered temporarily until 30 June 2010 to 2.8%. This provisional measure was extended by a half a year to 31 December 2010 within the context of the 2nd package of economic measures. The reduction of the contribution rate from 6.5% (2006) to 2.8% will help ease the burden considerably on both employers - by way of falling labour costs – and on employees – by way of rising net wages and salaries – to the tune of roughly €30bn per year. This relief has helped stabilise the situation on the German labour market.

The federal government has placed the statutory pension insurance system on a stable financial footing over the long-term. The contribution rate is not to exceed 20% in 2020 and 22% in 2030. At the same time, a legally prescribed level of security must be adhered to. Between 2012 and 2029, the general retirement age will be raised gradually to 67. Beginning in 2010, the federal government must submit an opinion every four years on whether, in light of developments on the labour market and with respect to the economic and social situation of older employees, the legal retirement age appears to be still justifiable.

The formula for pension adjustments is oriented on gross wage and salary developments. By introducing a fully-funded pension (the so-called *Riester Rente*), it takes into account the provisions made by employees themselves. The sustainability factor was included to account for demographically induced changes to the ratio of beneficiaries to contributors.

These modifications to the pension adjustment formula were tied to a protective clause which ensures that pensions cannot fall as a result of dampening factors. This original protective clause was already used in the pension adjustments in 2005 and 2006. In 2009, it was changed to ensure that any reduction in those wages covered by the adjustment would not lead to a reduction in pensions. The dampening effects will be allowed to take retroactive effect from 2011 by halving pension increases until there is no longer a need for compensation.

# 4 Macroeconomic situation and outlook to 2013

## *4.1 Assumptions underlying the macroeconomic forecast for 2010 and the medium-term to 2013*

The forecasts are based on the following assumptions:

- There will be a gradual recovery in the global economy during the 2010 to 2013 period forecast. The global economy will experience a 3¼% growth of real GDP in 2010. Prior to that global economic activity was heavily affected by the economic and financial crisis so that in 2009 global GDP was down on yearly average, despite recovering over the course of the year, by some 1%.
- The international exchange of goods and services will benefit from the global economic recovery. Following a marked decline in 2009, global trade is expected to pick up slightly in the coming years. The volume of global trade is set to increase in 2010 by roughly 4½%, having shrunk in the previous term by approximately 12 ½%. Thanks to its high competitiveness, Germany is particularly well positioned to profit from the upswing in world trade, such that German exporters will be able to defend their market shares well into the medium-term.
- The price of crude oil and the euro/US dollar exchange rate are based on technical assumptions corresponding to the respective average of the last weeks preceding the forecast. Given that global macroeconomic production is running below capacity, despite the economic recovery, no bottlenecks are expected over the course of the period forecast with regard to the supply of raw materials. The price of Brent oil is set at 75 US dollars for the entire forecast period. No fundamental changes are expected in relation to exchange rates. A dollar/euro exchange rate of 1.48 is assumed.
- The stabilising role of monetary policy is supported in this scenario by the fact that both cost and the demand-side developments are expected to dampen inflation. A further technical assumption is that the ECB's main refinancing rate will remain at 1.0% for the entire forecast period.
- With respect to the increase in effective earnings, it is assumed that, adjusted for price, these are within the scope of the increase in trend labour productivity.
- It is expected that the mid-term course of budget consolidation will continue at European level once the economic and financial crisis has been overcome.
- For the 2010 to 2013 period forecast it is assumed that the continued reform strategy to strengthen growth and employment in Germany will lead to an increase in potential growth.

## 4.2 *Macroeconomic situation in Germany in 2009*

During the last quarter of 2008 and the first quarter of 2009, Germany experienced a sharp economic downturn, the effects of the global economic and financial crisis being felt especially acutely in the particularly export-oriented manufacturing sector. Positive economic signals began to increase over the course of 2009. Spring 2009 saw a slight upturn, which proceeded to accelerate at the beginning of the 2nd half of the year. Real GDP was up 0.7% in working-day and seasonally adjusted terms, in the 3rd quarter on the previous quarter, which itself had seen a 0.4% rise. Although – viewed from the perspective of developments over the course of the year – the economic recovery continued to strengthen, a year-on-year comparison demonstrates clearly just how sharp the economic slump in the last quarter of 2008 and the first quarter of 2009 was. According to provisional estimates of GDP in 2009 by the Federal Statistical Office, economic performance was down on yearly average by 5.0% in real terms compared with the previous year, despite the economy picking up over the course of the year.

The starting point for the economic recovery in Germany was the gradual upturn in the global economy. The export of goods rose considerably in the 3rd quarter of 2009; exports are experiencing an upward trend, much like foreign demand for German industry products. The domestic economy is also showing signs of a turn for the better. The 3rd quarter saw a noticeable expansion in investments in buildings and in machinery and equipment. However, investment activity was down 20% on yearly average compared with the previous year. Private consumption, which had a stabilizing effect at the onset of the crisis, decreased in the 2nd half of 2009. This was also a consequence of the expiration of the scrapping bonus, which led to a markedly lower demand for cars.

The labour market remained robust in 2009. Given the extent of the economic slowdown, the drop in employment and the increase in unemployment can be said to have been on the whole very moderate. The broad expansion of short-time work, the decrease in overtime and in working time accounts, and a flexible adjustment of working time in businesses eased the effects of the economic slump. Against the background of economic recovery, the extended phase of short-time work might have been able to fulfil its intended "bridging" function in some sectors. Nevertheless, the fact that production is running significantly below normal capacity and that this is likely to remain the case even if the economy continues to recover represents a substantial risk in terms of future developments on the labour market.

2009 saw little activity with respect to prices, with developments increasing the purchasing power of private households. Developments are expected to remain calm for the near future. One reason for this assumption is the continued favourable upstream price development in the production chain.

## 4.3 *Short and medium-term outlook for the overall economy*

The leading indicators (e.g. orders received, ifo indicator of business expectations) point towards a continued economic recovery. In its latest forecast, the federal government expects real GDP to grow by 1.4 % in 2010. The level of economic activity will be favourably influenced by the economic recovery of the preceding year (carry-over effect). Nevertheless, production capacity for the economy as a whole will remain severely under-utilised in 2010. The expected expansion in macroeconomic demand will only gradually redress the under-employment situation in businesses.

Both foreign and domestic demand are expected to add momentum to growth. The upturn in global demand will lead to a marked expansion of German exports over the period being forecast. The fact that the German export industry is very price competitive on international comparison is likely to be to its advantage. This was aided by a long period of marked wage moderation before the crisis and consolidation of firms' balance sheets. Added to this is that in the early stages of the nascent global economic recovery, German exporters will benefit from the fact that their range of goods largely consists of investment goods. Against this background, the external balance of goods and services is expected to contribute significantly to growth in 2010 to the tune of possibly 0.8 percentage points. Domestic demand is expected to contribute to almost half of economic growth. However, private consumption will probably dampen macroeconomic development slightly. This is partially due to the scrapping bonus, which led to cars which would have been bought in 2010 being bought instead in 2009. Nonetheless, the drop in private consumption would have been a lot sharper had the federal government not decided to boost incomes by introducing further relief. Disposable income of private households will increase by 1.0%, markedly more than in the previous year, although these will feel the strain of the delayed reaction of the labour market. In contrast to private consumption, investment activity is expected to contribute to a broadening of domestic demand. The global economic recovery should see investment in equipment and machinery increase by 3.1%. These investments are likely to benefit from front-loading effects since improved conditions for depreciation allowance agreed in the first economic recovery programme apply only until the end of 2010. Businesses are likely to invest more on replacement and modernisation in order to maintain and improve their competitiveness. Investment in construction, carried largely by a markedly higher level of public investment, will be beneficial to economic growth on the whole. Here, the delayed effects of the measures introduced to stabilise the economy are expected to manifest themselves. Since businesses are not expected to expand, given the current over-capacity and the fact that existing production plants will suffice in most cases, private sector construction is likely to slow down economic development.

The slowdown in economic activity will be clearly noticed on the labour market in 2010. Up until the end of 2009, the labour market was largely protected by the effects of the crisis because of the strong expansion of short-time work and more flexible rules on working time. The federal government's forecast for 2010 predicts a decline in total employment of roughly 400,000 on yearly average. Due to a decreasing labour supply, the rise in the number of those registered unemployed is expected to be less than the fall in total employment (320,000).

It can be expected that the level of capacity utilisation will be well below the long-term average this year, i.e. GDP will be well below potential. There is a negative output gap which is expected to remain, albeit to a lesser extent, until the end of the medium-term forecast period.

Potential growth, which describes the long-term development of GDP where macroeconomic production capacity is being utilised to a normal degree, is expected to be a little under 1% in 2010, rising slightly over the course of the medium-term period forecast to reach an estimated 1½% in 2013. Here, the economic slowdown and the accompanying curtailment of investment activity and the labour force have noticeably dampened macroeconomic production potential. Real GDP is expected to grow over the entire medium-term forecast period (2009 to 2013) by roughly ½% on yearly average. Here it is assumed on the demand side that global trade becomes more dynamic over the course of the forecast period so that German net exports make a positive contribution to economic growth. Most economic growth will come from domestic demand, however. Both private consumption and investment will have a favourable effect on the development of GDP. Private consumption will support economic growth over the medium-term forecast period, and will grow more than GDP over the entire forecast period. The increase in business investment will probably be disproportionately higher than that of macroeconomic production. Employment could rise by some 100,000 persons to approximately 40.4m. Given the expected expansion in the labour supply, the number of persons unemployed is expected to fall less strongly than the numbers in total employment rise.

The federal government's forecast is accompanied by risks and opportunities. One of the risks in particular is that, especially as a result of uncertainties in foreign trade, economic growth develops less favourably than expected. There is a continued danger of further, negative effects of the financial market crisis on the real economy, despite the progress made in stabilising the financial sector. Unsolved problems on the financial markets in particular could lead via an increase in company bankruptcies (defaults) and a more restrictive lending line by banks for commercial loans to a less favourable macroeconomic development. In addition, a continued slump in the economies of important European trading partners could hinder economic development in Germany. Less favourable developments in employment numbers could also have negative knock-on effects for private consumption.

On the other hand, there is also a realistic chance that the economy develops more favourably than assumed. The effects of the expansive economic and fiscal policy measures undertaken at the international level could be more strongly mutually reinforcing than expected and help lead economies out of the crisis earlier than predicted. A stronger global economic recovery could lead to a quicker recovery in German exports. In this case, an additional impetus from foreign trade can be expected, especially by way of an increased demand for investment goods. Structural reforms have made the labour market more flexible, which could lead to the economic crisis being overcome more quickly.

# 5 Development of the public budgets

## *5.1 Development of net borrowing/net lending*

### *Deterioration of the general government budget balance as a result of the crisis*

The sharp recession has left a deep mark in Germany's public budgets. According to provisional results of the Federal Statistical Office, the general government budget balance worsened in 2009 to -3.2% of GDP, having shown a slight surplus in the two preceding years. Thus, the deficit exceeded the 3% reference value set out in the Maastricht Treaty (Table 2). This was the result primarily of the decision to allow the automatic stabilisers to work to their full extent, but also reflected the measures undertaken to stabilise the economic situation and improve the long-term growth perspectives in Germany (see Chapter 3.1). In contrast, the measures implemented to stabilise the financial market had once again little effect on net borrowing/lending, since their recording increased the deficit to a slight degree only.

**Table 2: Development of the general government budget balance**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| | - % of GDP - | | | | | |
| **January 2010 update** | **0.0** | **-3.2** | **-5 1/2** | **-4 1/2** | **-3 1/2** | **-3** |
| January 2009 update | 0.0 | -3 | -4 | -3 | -2 1/2 | - |

Figures are rounded to one half of a percentage point of GDP.

The general government deficit will rise further this year to 5½% of GDP. The repeated deterioration of net borrowing is due primarily to the measures which continue into 2010 aimed at stimulating the economy and boosting growth. These are placing the central, state and local budgets and that of the social security funds under far more strain than last year. This development is also influenced by weak domestic demand and a further deterioration of the situation on the labour market. Thus, the fiscal policy course will continue to have an expansive effect in 2010.

From 2011, in accordance with the national constitutional budget rule and the recommendations of the ECOFIN Council, and in the interest of a fiscal policy course which is built around long-term sustainability, Germany will begin reducing its deficit, which was accumulated as a result of the crisis. From 2011 to 2013, the general government deficit will gradually be reduced to below 3% of GDP, adhering once more to the Maastricht reference value. The political aims of the coalition agreement of 26 October 2009 are reflected in the tables relating to public budgets only to the extent that they have already been sufficiently specified by way of legislative proposals. As set out in its 2010 Annual Economic Report, the federal government will implement the coalition agreement in line with the rules of the European Stability and Growth Pact.

### *Net borrowing/net lending by level of government*

The marked deterioration of the general government budget balance in 2009 was felt at every level of government. The financing deficit of the Federation including its special funds[1] increased by 1.1 percentage points to 1.7% of GDP (Table 3). This year, once again, the further increase in the general government deficit will be largely due to the deterioration at federal level to a deficit of 3½% of GDP. This is a result of the fact that a large part of the package of measures adopted to stabilise the economy, in particular spending within the context of the Investment in the Future Act (*Zukunftsinvestitionsgesetz*) is essentially borne by the Federation.

In presenting the consolidation efforts needed at federal level until the end of the programme horizon, a technical assumption was made under which the consolidation effort is spread equally between all forms of expenditure, with the exception of interest expenditure and the transfers to other government levels and abroad. In summer 2010, the federal government will outline the specific measures to be taken to meet the requirements of the national constitutional budget rule (see Chapter 3.1) and the recommendations of the ECOFIN Council (see Chapter 2). The required reduction of the structural deficit in the federal budget will lead to the nominal deficit at federal level being reduced substantially by 2013 to roughly 1½% of GDP.

**Table 3: Budget balances by level of government**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| | in relation to GDP (%) | | | | | |
| Federation and special funds | -0.6 | -1.7 | -3 1/2 | -2 1/2 | -2 | -1 1/2 |
| States and local government | 0.3 | -1.0 | -2 | -2 | -1 1/2 | -1 1/2 |
| Social security funds | 0.3 | -0.5 | -0 | -0 | -0 | -0 |
| General government | 0.0 | -3.2 | -5 1/2 | -4 1/2 | -3 1/2 | -3 |

Figures are rounded to a half a percentage point of GDP.

The budget balances of states (*Länder*) and local government, whose budgets were balanced and in surplus respectively in 2008, deteriorated on aggregate last year to much the same extent as that of the Federation, resulting in a deficit of 1.0% of GDP. This deficit is also forecast to rise further in 2010, again similarly to the federal deficit, to 2% of GDP approximately. Since the transitional period up to the regular application of the new national constitutional budget rule is longer at states' level and the current level of net borrowing is lower, substantially less consolidation efforts are needed on average of the *Länder* and of years required in comparison to the federal level to reach structurally balanced budgets. Nevertheless, together with the Federation, the *Länder* have voiced their clear support of both the European Stability and Growth Pact and the national budget rule. They committed themselves in the Financial Planning Council of December 2009 to reduce the structural deficit in continuous steps from 2011 und to meet the 3% deficit criteria from 2013. The deficit at states and local level will sink to 1½% of GDP by 2013.

The economic crisis and the stability measures undertaken also left their mark on the social security funds. In 2008, these were running a surplus of 0.3% of GDP. Their budget balance fell to -0.5% of

[1] Federal Railways Fund, Compensation Fund, Redemption Fund for Inherited Liabilities, ERP Special Fund, Financial Market Stabilisation Fund, Investment and Repayment Fund, Special Fund to Extend Childcare, BPS-PT (Post Officials Pension Fund).

GDP in the past year. This was caused primarily by the dramatic deterioration in the budget of the Federal Labour Agency, which was put under heavy strain by the marked increases in the costs of the unemployment insurance fund and the lower contribution rate for unemployment insurance. This year, the Federal Labour Agency, and as a consequence the social security funds, would again have posted a further deficit, albeit slightly lower than last year, were the Federation not to provide a transfer. The social security funds will achieve a close to balance budget this year.

### *5.2 Development of government revenue and expenditure*

#### *Government revenue on the decline due to the economic crisis and measures taken*

Last year, primarily as a result of the measures introduced in the economic recovery programme to relieve the burden on citizens and business, tax revenue on the whole declined even more than GDP, such that there was a slight drop in the tax-to-GDP ratio to 23.5% (Table 4). Another decline in tax revenue can be expected for this year as a consequence of further relief measures. Since GDP developments over the same timeframe are expected to be markedly more positive, there is likely to be a substantial decline of one percentage point in the tax-to-GDP ratio to 22½%. Although tax revenues are expected to return to positive trends in the coming year, they will increase at a proportionately slower rate than the economy as a whole. This will lead to a further slight reduction in the tax-to-GDP ratio. However, this ratio is forecast to return to roughly 22½% by the end of the period being forecast.

In contrast to the tax ratio, the ratio of social security contributions to GDP rose in 2009 by 0.5 percentage points to 17.1%. Here, two effects served to over-compensate the reduction in the contribution rate to unemployment insurance from 3.3% to 2.8%. Firstly, given the comparatively minor effect that the crisis had on the labour market, wage developments remained relatively stable. Secondly, there was an increase in the contribution rates to statutory health insurance (only in the first half of 2009) and to social long-term care insurance. This year, as a result of slightly lower gross wages and salaries, there will be a mild decline in the ratio of social security contributions to GDP. Despite an increase in the contribution rate to unemployment insurance, the ratio will experience a further slight drop in the coming year to 16½%, due to the fact that gross wages and salaries increase at a lesser rate than nominal GDP. The ratio is expected to remain at this level for the remainder of the period forecast.

Consequently, the total tax ratio rose to 40.6% in 2009, although the fiscal charges themselves fell by 2.4%. The total tax ratio is forecast to fall to 38½% by 2011 as a result of the expected declines in both the tax-to-GDP and the social security contributions to GDP ratios. Thereafter it is expected to rise slightly to 39%.

Overall, government revenue fell by 2.2% in the past year. Looked at on an average of the period in question, it is expected to rise by 1½% per year. The government revenue ratio rose in 2009 from 43.7% to 44.4%. It will fall this year to 42½% and thereafter will rest until 2013 at 42%, its lowest level since German reunification.

**Table 4: Taxes and social contributions in % of GDP**

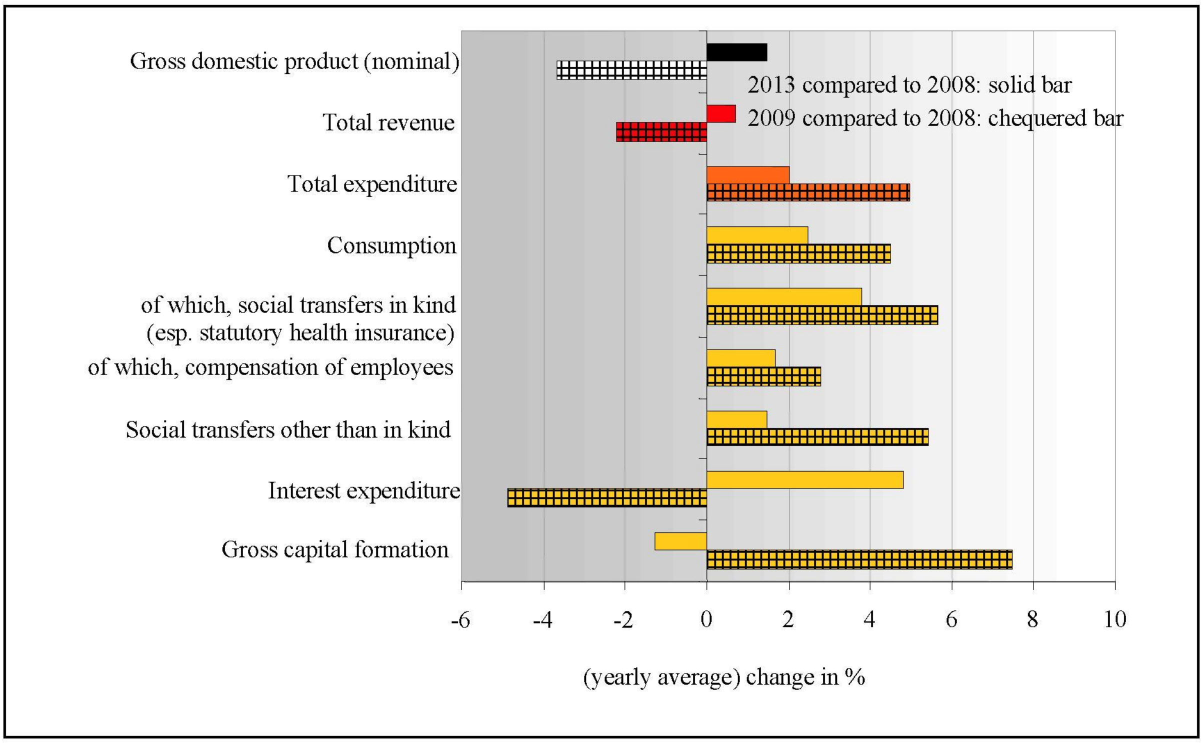
| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| | - % of GDP - | | | | | |
| **Taxes** | **23.7** | **23.5** | **22 1/2** | **22** | **22** | **22 1/2** |
| **Social contributions** | **16.4** | **17.1** | **17** | **16 1/2** | **16 1/2** | **16 1/2** |
| **Taxes + social contributions** | | | | | | |
| **January 2010 update** | **40.1** | **40.6** | **39** | **38 1/2** | **39** | **39** |
| January 2009 update | 40.2 | 40 | 39 | 39 | 39 1/2 | - |

Differences between the total tax ratio and the sum of the tax and social contribution ratio are down to rounding. The figures for the forecast years are rounded to a half a percentage point of GDP.

## *Government expenditure increased at a disproportionate rate*

Government expenditure posted a sharp increase of 5% in the past year. This can be put down to both the automatic stabilizers and the economic recovery measures. Thus, above-average increases were posted in particular with respect to social transfers other than in kind to private households (+5.4%, as a result of the increase in child benefit and payment of a one-off child bonus), gross fixed capital formation (+7.5%, as a result of the Investment in the Future Act) and subsidies (+16.8%, as a result of the Federal Labour Agency repayment for the social insurance contributions which companies had to bear for employees on short-time work arrangements). Social transfers in kind also increased noticeably (+5.7%), whereas compensation for employees rose at a below-average rate only (+2.8%). The only area in which spending was down was interest expenditure (-4.9%, see figure below), which was due to lower interest rates.

**Figure: Average annual development of public revenue and expenditure and GDP from 2008 to 2013 and in 2009, in % compared to preceding year**



However, the substantial net borrowing will lead to higher spending on interest, increasing at roughly 5% per year, returning the highest average increase among all the areas of expenditure over the entire programme period from 2008 to 2013. In contrast, gross capital formation will fall by an overall yearly average of 1½% over this period, since the investment in the future programme comes to an end and investments will fall to below their original level. There will also be declines, in parts substantial, in the remaining areas of expenditure, in particular with respect to those which were strongly affected by the economic recovery measures. In addition, the fact that the technical assumption, by which the level of federal consolidation required will be met solely on the expenditure side, also leads to a substantial overall reduction in government expenditure in the forecast must also be borne in mind.

The slump in GDP together with the marked increase in spending led last year to a noticeable rise in the government spending ratio, i.e. government spending in relation to GDP, by almost 4 percentage points to 47.6% (Table 5). Since the economic recovery programmes largely come into effect this year, there will be a further increase in the government spending ratio to 48%, despite the rise in GDP. Only next year will the government spending ratio begin to decline successively, reaching 45% in 2013. The technical assumption that the Federation will consolidate on the expenditure side also contributes to this.

**Table 5: General government expenditure in % of GDP**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| | - government expenditure as a % of GDP - | | | | | |
| **January 2010 update** | **43.7** | **47.6** | **48** | **47** | **46** | **45** |
| January 2009 update | 44.0 | 46 1/2 | 46 1/2 | 45 1/2 | 45 1/2 | - |

Figures rounded to half a percentage point of GDP.

### *5.3 Development of structural budget balance and reduction of the excessive deficit*

#### *2009 government budget burdened principally by automatic stabilisers*

The deterioration in the general government budget balance of more than 3 percentage points in the previous year is due primarily to the fact that the automatic stabilisers were allowed to take effect. The structural deficit, i.e. the financing deficit net of cyclical and temporary effects, rose only by ½ a percentage point to 1½% of GDP (Table 6).

**Table 6: Structural and nominal general government budget balance and GDP**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| Structural balance (% of GDP) | -1 | -1 1/2 | -4 1/2 | -4 | -3 | -2 1/2 |
| General government net borrowing/ net lending (% of GDP) | 0.0 | -3.2 | -5 1/2 | -4 1/2 | -3 1/2 | -3 |
| Real GDP (% change yoy) | 1.3 | -5.0 | 1.4 | 2 | 2 | 2 |

Figures rounded to half a percentage point of GDP.

In contrast, the deterioration in the general government budget balance this year is due mainly to structural factors – the structural deficit will grow to 4½% of GDP. Given the continued negative – albeit in comparison to the previous years and in absolute terms, slight – output gap, the increase in the structural deficit is higher than that of the actual deficit. However, as a result of the budget consolidation in the coming years, there will be a substantial decline in the structural deficit to 2½% of GDP by 2013.

***Reduction of the excessive deficit by 2013 and medium-term budget target***

In keeping with the recommendations of the ECOFIN Council, Germany will reduce its excessive deficit by 2013. To this end, again in keeping with the recommendations, measures will be introduced to reduce the structural deficit by an average of at least 0.5% of GDP per year. The structural deficit will fall by about 2 percentage points over the coming three years. Germany is pursuing a target of a close-to-balance government budget in structural terms. The medium-term objective of -½% of GDP, which results from using the new calculation modalities which take ageing costs into account[2], will be supported by the new budget rule adopted by both the Federation and the *Länder*.

### *5.4 Development of the level of debt*

The dramatic increase in net borrowing, the recapitalisation and other measures taken to stabilise the financial market which in contrast to the deficit completely increase the level of debt, and by no small measure the decline in GDP all led to a powerful increase in the ratio of government debt to GDP from 65.9% to 72½% in 2009 (Table 7).

The ratio of government debt to GDP will increase substantially once again this year, the increase expected to be four percentage points. In forecasting the level of debt, only those financial market stabilisation measures known to date are taken into account. Here it is assumed that the level of debt will not be increased through the establishment of bad banks out of public banks. The increase in the level of debt is thus mainly due to the repeated, albeit much higher, growth in net borrowing. Although the rate of growth will slow down in the coming years, the trend will not change direction over the course of the programme period. The ratio of government debt to GDP is expected to reach roughly 82% in 2013. This forecast is based on the assumption that no securities which the state took over in its endeavours to stabilize the financial market will fall due or be returned to the financial institution in question before 2013. Such a development would serve to reduce the level of debt. By the same token, further stabilization measures could increase the level of debt even more.

While it is true that the inclusion of the effects of the financial market crisis skews the actual influence of fiscal policy on the ratio of government debt to GDP, the 60% of GDP reference value of the Maastricht Treaty would have been clearly exceeded in any case.

[2] The medium-term objective of -½% of GDP results under both possible calculation methods, i.e. whether 33% of the costs as a result of ageing are prefinanced or all costs as a result of ageing are covered until 2040.

**Table 7: Government debt in % of GDP**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| | - in % of GDP - | | | | | |
| **January 2010 update** | **65,9** | **72 1/2** | **76 1/2** | **79 1/2** | **81** | **82** |
| January 2009 update | 65 1/2 | 68 1/2 | 70 1/2 | 71 1/2 | 72 1/2 | - |

Figures rounded to half a percentage point.

## *5.5 Sensitivity of the forecast of general government budget balance*

The sensitivity analysis shows the situation where developments deviate from the macroeconomic assumptions. The sensitivity analysis looks at two alternative scenarios which result from a reduction and an increase in the annual growth rate of real GDP of ½ a percentage point, respectively, during the remaining programme period. A constant GDP deflator and a constant GDP composition compared to the baseline scenario are assumed.

The same picture emerges under the sensitivity analysis in qualitative terms. In both scenarios, the deficit rises once again this year, before decreasing in the years thereafter. In quantitative terms, however, marked differences result (Table 8). Under the scenario with weaker macroeconomic performance, budget consolidation is much more difficult. The general government budget balance would still be -4% of GDP at the end of the programme period. This would mean that the recommendation to reduce the excessive deficit by 2013 would not be met. Thus the sensitivity analysis shows that the consolidation steps in the baseline scenario are minimum requirements. In order not to endanger the prospects of meeting the recommendations with respect to the excessive deficit, consolidation efforts should be rather stronger than assumed in the baseline scenario. At the same time, were GDP to develop at a yearly rate which is ½ a percentage point more favourable than assumed in the baseline scenario, this would mean that the deficit could be reduced by 2013 to even 1½ % of GDP and the government budget in Germany might reach its target of being structurally close-to-balance sooner than expected.

**Table 8: Sensitivity of the forecast of the general government balance**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| **GDP as in** | **- general government budget balance in % of GDP -** | | | | | |
| **- baseline scenario** | 0.0 | -3.2 | -5 1/2 | -4 1/2 | -3 1/2 | -3 |
| **- alternative scenarios** | | | | | | |
| • - ½ pp p.a. compared to baseline | | | -6 | -5 1/2 | -4 1/2 | -4 |
| • + ½ pp p.a. compared to baseline | | | -5 | -4 | -3 | -1 1/2 |

Figures rounded to half a percentage point of GDP.

# Appendix

## Table 9: General government budgetary prospects

| | ESA Code | 2008 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|---|
| | | bn € | % of GDP | % of GDP | % of GDP | % of GDP | % of GDP | % of GDP |
| **Net lending (EDP B.9) by sub-sector** | | | | | | | | |
| **1. General government** | S.13 | 1.1 | 0.0 | -3.2 | -5 1/2 | -4 1/2 | -3 1/2 | -3 |
| **2. Central government** | S.1311 | -14.1 | -0.6 | -1.7 | -3 1/2 | -2 1/2 | -2 | -1 1/2 |
| **3. State and local government** | | 7.0 | 0.3 | -1.0 | -2 | -2 | -1 1/2 | -1 1/2 |
| **5. Social security funds** | S.1314 | 8.2 | 0.3 | -0.5 | -0 | -0 | -0 | -0 |
| **General government (S13)** | | | | | | | | |
| **6. Total revenue** | TR | 1091.8 | 43.7 | 44.4 | 42 1/2 | 42 | 42 | 42 |
| **7. Total expenditure 1** | TE [1] | 1090.7 | 43.7 | 47.6 | 48 | 47 | 46 | 45 |
| **8. Net lending/borrowing** | EDP B.9 | 1.1 | 0.0 | -3.2 | -5 1/2 | -4 1/2 | -3 1/2 | -3 |
| **9. Interest expenditure** | EDP D.41 | 67.1 | 2.7 | 2.7 | 2 1/2 | 2 1/2 | 3 | 3 |
| **10. Primary balance** | | 68.1 | 2.7 | -0.6 | -3 | -2 | - 1/2 | 1/2 |
| **11. One-off and other temporary measures**[1] | | | -0.4 | -0.1 | -0 | -0 | -0 | 0 |
| **Selected components of revenue** | | | | | | | | |
| **12. Total taxes**(12=12a+12b+12c) | | 592.6 | 23.7 | 23.5 | 22 1/2 | 22 | 22 | 22 1/2 |
| **12a. Taxes on production and imports** | D.2 | 311.4 | 12.5 | 12.6 | 12 1/2 | 12 1/2 | 12 1/2 | 12 1/2 |
| **12b. Taxes on income, wealth, etc** | D.5 | 281.2 | 11.3 | 10.9 | 10 | 9 1/2 | 10 | 10 |
| **12c. Capital taxes** | D.91 | 0.0 | 0.0 | 0.0 | -0 | -0 | 0 | 0 |
| **13. Social contributions** | D.61 | 408.1 | 16.4 | 17.1 | 17 | 16 1/2 | 16 1/2 | 16 1/2 |
| **15. Other** | | 91.1 | 3.7 | 3.8 | 3 1/2 | 3 1/2 | 3 1/2 | 3 |
| **16=6. Total revenue** | TR | 1091.8 | 43.7 | 44.4 | 42 1/2 | 42 | 42 | 42 |
| **p.m.: Tax burden (D.2+D.5+D.61)** | | | 40.1 | 40.6 | 39 | 38 1/2 | 39 | 39 |
| **Selected components of expenditure** | | | | | | | | |
| **17. Intermediate Consumption**<br>**Social transfers in kind**<br>**Compensation of employees**<br>**Other taxes on production** | P.2<br>D.63<br>D.1<br>D.29 | 464.5 | 18.6 | 20.2 | 20 1/2 | 20 | 20 | 19 1/2 |
| **18b. Social transfers other than in kind** | D.62 | 421.6 | 16.9 | 18.5 | 18 1/2 | 18 | 17 1/2 | 17 |
| **19=9. Interest expenditure** | EDP D.41 | 67.1 | 2.7 | 2.7 | 2 1/2 | 2 1/2 | 3 | 3 |
| **20. Subsidies** | D.3 | 28.0 | 1.1 | 1.4 | 1 1/2 | 1 1/2 | 1 1/2 | 1 1/2 |
| **21. Gross fixed capital formation** | P.51 | 37.4 | 1.5 | 1.7 | 2 | 1 1/2 | 1 1/2 | 1 1/2 |
| **22. Other** | | 72.1 | 2.9 | 3.2 | 3 | 3 | 3 | 2 1/2 |
| **23=7. Total expenditure** | TE[1] | 1090.7 | 43.7 | 47.6 | 48 | 47 | 46 | 45 |
| p.m.: Government consumption (nominal) | P.3 | 451.8 | 18.1 | 19.6 | 20 | 19 1/2 | 19 1/2 | 19 |

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

## Table 10: General government debt developments (“Maastricht” level of debt)

| % of GDP | ESA Code | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|
| **1. Gross debt** | | 65.9 | 72 1/2 | 76 1/2 | 79 1/2 | 81 | 82 |
| **2. Change in gross debt ratio** | | 2.7 | 4 | 5 1/2 | 5 | 4 | 3 |
| **Contributions to changes in gross debt** | | | | | | | |
| **3. Primary balance** | | -2.7 | 0.6 | 3 | 2 | 1/2 | - 1/2 |
| **4. Interest expenditure** | EDP D.41 | 2.7 | 2.7 | 2 1/2 | 2 1/2 | 3 | 3 |
| **5. Stock-flow adjustment** | | 2.7 | 1 | 0 | 1/2 | 1/2 | 1/2 |

**Table 11: Divergence from previous update**

| | ESA Code | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|
| **Real GDP growth (%)** | | | | | | | |
| **Previous update** | | 1.3 | -2.3 | 1 | 1 | 1 | |
| **Current update** | | 1.3 | -5.0 | 1.4 | 2 | 2 | 2 |
| **Difference** | | 0.0 | -2 1/2 | 0 | 1/2 | 1/2 | |
| **General government net lending (% of GDP)** | EDP B.9 | | | | | | |
| **Previous update** | | 0.0 | -3 | -4 | -3 | -2 1/2 | |
| **Current update** | | 0.0 | -3.2 | -5 1/2 | -4 1/2 | -3 1/2 | -3 |
| **Difference** | | 0.0 | - 1/2 | -1 1/2 | -2 | -1 | |
| **General government gross debt (% of GDP)** | | | | | | | |
| **Previous update** | | 65.4 | 68 1/2 | 70 1/2 | 71 1/2 | 72 1/2 | |
| **Current update** | | 65.9 | 72 1/2 | 76 1/2 | 79 1/2 | 81 | 82 |
| **Difference** | | -0.5 | -4 | -6 | -8 | -8 1/2 | |

**Table 12: Forecast of macroeconomic development 2009 to 2013(1)**

| | ESA Code | 2008 | 2008 | 2009 | 2010 | 2011 to 2013(4) |
|---|---|---|---|---|---|---|
| | | Index | % change p.a. | | | |
| **Real GDP, chain index** | B1g | 110.26 | 1.3 | -5.0 | 1.4 | 2 |
| **Nominal GDP (€ bn)** | B1g | 2495.80 | 2.8 | -3.7 | 2.0 | 3 |
| **Demand components of real GDP, chain index** | | | | | | |
| **Private consumption expenditure(2)** | P.3 | 102.94 | 0.4 | 0.4 | -0.5 | 1 |
| **Government final consumption** | P.3 | 106.99 | 2.1 | 2.7 | 2.0 | 1/2 |
| **Gross fixed capital formation** | P.51 | 105.93 | 3.1 | -8.6 | 2.1 | 4 |
| **Changes in inventories** (GDP growth contribution)(3) | P.52 + P.53 | - | 0.4 | -0.8 | 0.1 | 0 |
| **Exports** | P.6 | 168.73 | 2.9 | -14.7 | 5.1 | 3 |
| **Imports** | P.7 | 147.12 | 4.3 | -8.9 | 3.4 | 2 1/2 |
| **Contribution to GDP growth(3)** | | | | | | |
| **Domestic demand (without inventories)** | | - | 1.2 | -0.9 | 0.5 | 1 1/2 |
| **Changes in inventories** | P.52 + P.53 | - | 0.4 | -0.8 | 0.1 | 0 |
| **External balance of goods and services** | B.11 | - | -0.3 | -3.4 | 0.8 | 1/2 |

(1) 2008, 2009: Provisional result of the Federal Statistical Office January 2010;
2010: Result of the annual forecast 2010;
2011 to 2013: medium-term forecast from January 2010 modified to reflect the results of the annual forecast.
(2) Including private non-profit organisations.
(3) Contribution to GDP growth rate.
(4) Rounded to ½.

## Table 13: Price development – deflators[1]

| | ESA Code | | 2009 | 2009 | 2010 | 2011 to 2013 [3] |
|---|---|---|---|---|---|---|
| | | Index | % change p.a. | | | |
| **GDP** | | 109.75 | 1.5 | 1.4 | 0.6 | 1 |
| **Private consumption expenditure[2]** | | 112.79 | 2.1 | 0.1 | 1.1 | 1 1/2 |
| **Government final consumption** | | 107.74 | 1.6 | 1.7 | 1.5 | 1 1/2 |
| **Gross fixed capital formation** | | 106.86 | 1.7 | -0.5 | -0.4 | 1 |
| **Exports** | | 101.53 | 0.6 | -3.0 | 0.6 | 2 |
| **Imports** | | 102.15 | 1.4 | -6.1 | 1.4 | 2 1/2 |

(1) 2008, 2009: Provisional result of the Federal Statistical Office January 2010;
2010: Result of the annual forecast 2010;
2011 to 2013: medium-term forecast from January 2010 modified to reflect the results of the annual forecast.
(2) Including private non-profit organisations.
(3) Rounded to ½.

## Table 14: Labour market development[1]

| | | 2008 | 2008 | 2009 | 2010 | 2011 to 2013[4] |
|---|---|---|---|---|---|---|
| | ESA Code | Level | % change p.a. | | | |
| **Employment, persons (domestic) (m)** | | 40. 279 | 1.4 | -0.1 | -1.0 | 1/2 |
| Employment, hours worked (bn. hours) | | 57.58 | 1.3 | -2.9 | 0.3 | 1 |
| **Unemployment rate (%)** | | - | 7.2 | 7.6 | 8.3 | 8 |
| **Labour productivity[2] (2000=100)** | | 107.15 | -0.1 | -4.9 | 2.4 | 1 1/2 |
| Labour productivity[3] (2000=100) | | 110.4 | 0.0 | -2.2 | 1.1 | 1 |
| **Compensation of employees (€bn.)** | D.1 | 1 224.01 | 3.7 | -0.1 | -0.2 | 2 1/2 |
| **Compensation per employee (€)** | | 34147 | 2.1 | 0.0 | 0.9 | 2 |

(1) 2008, 2009: Provisional result of the Federal Statistical Office January 2010;
2010: Result of the annual forecast 2010;
2011 to 2013: medium-term forecast from January 2010 modified to reflect the results of the annual forecast.
(2) Labour productivity per employee.
(3) Labour productivity per hour worked.
(4) Rounded to ½.

**Table 15: Sectoral balances[1]**

| in % of GDP | ESA Code | 2008 | 2009 | 2010 | 2011[3] | 2012[3] | 2013[3] |
|---|---|---|---|---|---|---|---|
| **1. Net borrowing/lending vis-à-vis rest of world** | B.9 | -6.6 | -4.5 | -4.9 | -5 | -5 1/2 | -5 1/2 |
| *of which* | | | | | | | |
| - Balance on goods and services | | 6.2 | 4.1 | 4.6 | 4 1/2 | 5 | 5 |
| - Balance on primary incomes and transfers | | 0.4 | 0.4 | 0.3 | 1/2 | 1/2 | 1/2 |
| - Capital account | | 0.0 | 0.0 | 0.0 | -0 | 0 | 0 |
| 2. Financial balance of private households[2] | B.9 | 5.7 | 6.1 | 6.2 | 6 | 5 1/2 | 5 |
| 3. Financial balance of general government | EDP B.9 | 0.0 | -3.2 | | | | |

(1) 2008, 2009: Provisional result of the Federal Statistical Office January 2010;
2010: Result of the annual forecast 2010;
2011 to 2013: medium-term forecast from January 2010 modified to reflect the results of the annual forecast.
(2) Including private non-profit organisations.
(3) Rounded to ½.

**Table 16: Assumptions**

| | 2008 | 2009 | 2010[1] | 2011 to 2013[1] |
|---|---|---|---|---|
| **Short-term interest rate (annual average)** | 3.9 | 1.2 | 1.0 | 1.0 |
| **Long-term interest rate (annual average)** | | - | - | - |
| **US-dollar/euro exchange rate (annual average)** | 1.27 | 1.39 | 1.48 | 1.48 |
| **Nominal effective exchange rate** | - | - | - | - |
| Exchange rate to euro (annual average); non-euro zone, ERM II countries | - | - | - | - |
| **Global economic growth excluding EU** | - | - | - | - |
| **GDP EU-27** | - | - | - | - |
| **Growth of German sales markets** | - | - | - | - |
| **Global imports excluding EU** | - | - | - | - |
| **Oil price (Brent, USD/Barrel)** | 97 | 62 | 75 | 75 |

(1) Technical assumption