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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

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1. INTRODUCTION

Germany submitted its Draft Budgetary Plan for 2015 on 10 October 2014 in compliance with Regulation (EU) No 473/2013. 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 of a structural deficit not exceeding 0.5% of GDP.

As the debt ratio was 77.6% 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 also subject to the transitional arrangements as regards compliance with the debt reduction benchmark. In this period, it should ensure sufficient progress towards compliance. Following the transitional period, Germany needs to comply with the debt reduction benchmark as of 2015.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2014 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 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 2014-2015 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations adopted by the Council on 8 July 2014, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying the Draft Budgetary Plan for 2015 is based on the federal government's macroeconomic forecast published on 15 April 2014, while for the year 2013 quantitatively and methodologically revised National Accounts statistics published in September 2014 have been taken into account. In 2013, economic growth was still affected by the slowdown in global economic activity and the prevailing uncertainty caused by the debt crisis, but the German economy turned on the road to recovery. GDP continued to decline in the first quarter of 2013, also due to exceptionally harsh winter weather. In the subsequent quarters, some weather-related catching up took place and underlying dynamics of economic activity regained momentum. According to official data published in September, the acceleration of growth came to a halt and even reversed in the first half of 2014, although weather effects caused strong quarterly fluctuations.

The macroeconomic scenario underlying the Draft Budgetary Plan implies continued moderate growth, leading real GDP to increase by 1.8% in 2014 and 2.0% in 2015. Growth is expected to be almost exclusively driven by domestic demand in both years. For 2015, growth of private consumption and equipment investment is expected to accelerate further on the back of a robust labour market, rising wages and low interest rates. Annual potential growth is estimated at 1.5% from 2013 to 2015. The macroeconomic outlook underlying the Draft Budgetary Plan is broadly in line with the Stability Programme's macroeconomic scenario published in April, as changes in some components offset each other with regard to aggregate annual GDP growth and potential growth.

However, the macroeconomic scenario underlying the Draft Budgetary Plan describes a significantly more optimistic scenario for economic growth in 2014 and 2015 than the Commission 2014 autumn forecast, while differences in labour market projections are markedly less pronounced.[1] Contrary to the Draft Budgetary Plan's scenario, the Commission forecast expects economic activity to remain weak until the first half of 2015. Notably, the recovery in corporate investment that has been interrupted in the second quarter of 2014 is expected to resume more hesitantly, while private and government consumption is also projected to grow at significantly lower rates. Along with considerably higher GDP growth projections and only moderately higher potential growth estimates for both 2014 and 2015, the still negative but narrowing output gap estimate for 2015 underlying the Draft Budgetary Plan markedly diverges from the Commission forecast, which projects a continued increase in the underutilisation of production capacities in 2015.

Box 1: The macro economic 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 is not formally endorsed by an independent body as defined in Regulation (EU) No 473/2013. The federal government presents three macroeconomic forecasts each year, the first one usually in January as part of the Annual Economic Report, followed by spring and autumn forecasts published in April and October, respectively. The spring and autumn forecasts are produced by the Inter-departmental Macroeconomic Forecasting Group under the direction of the Federal Ministry for Economic Affairs and Energy, involving specialists from the federal ministries, the *Deutsche Bundesbank*, the Institute for Employment Research and the Federal Statistical Office. However, the preparation of the government's projections involves the independent Joint Economic Forecast (*Gemeinschaftsdiagnose*) which is issued twice a year by leading research institutes shortly before the government's spring and autumn projections. The Joint Economic Forecast has been conducted since 1950 and operates within the framework of research mandates awarded by the government through a call for tenders. The government considers the Joint Economic Forecast as a benchmark for its own forecasts and customarily explains deviations in the monthly report of the Federal Ministry for Economic Affairs and Energy, although it is not obliged to do so. In addition, the Working Party on tax revenue forecasting, an independent advisory council to the Federal Ministry of Finance, prepares reports biannually in spring and autumn on the basis of the federal government's macroeconomic forecasts. Besides delegates of federal ministries, the Working Party consists of representatives from five economic research institutes, the Federal Statistical Office, the *Deutsche Bundesbank*, the German Council of Economic Experts, the finance ministries of

[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 forecast.

the *Länder* and the Federal Union of Central Associations of Local Authorities. The tax estimates of the Working Party provide the basis for both the annual budget and the medium-term financial planning.

The submitted Draft Budgetary Plan is largely based on the government draft of the 2015 federal budget of 2 July 2014, which in turn is based on the spring issues of the government's macroeconomic forecast and the projections of the Working Party on tax revenue forecasting, published already in April and May. Furthermore, it is based on the medium-term public finance projections 2014-2018 for the *Länder* and local authorities of 9 July 2014 as well as an updated projection for the social security funds. The Draft Budgetary Plan does not factor in the autumn issues of the government's macroeconomic projections, the Joint Economic Forecast and the tax revenue projections, which were published only after the submission deadline of 15 October, although they can still be taken into account in the parliamentary decision making process for the federal budget. Moreover, the Stability Programme, submitted in April, is based on the federal government's January forecast, which is usually prepared without using an updated independent Joint Economic Forecast as a benchmark.

Table 1. Comparison of macroeconomic developments and forecasts

	2013	2014			2015		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	0.1	1.8	1.8	1.3	2.0	2.0	1.1
Private consumption (% change)	0.8	1.4	1.5	1.0	1.6	1.7	1.3
Gross fixed capital formation (% change)	-0.7	3.5	4.1	2.9	5.0	4.7	2.0
Exports of goods and services (% change)	1.6	4.1	4.1	3.3	4.8	4.6	4.2
Imports of goods and services (% change)	3.1	5.0	4.7	3.9	5.5	5.1	4.8
Contributions to real GDP growth:							
- Final domestic demand	0.5	1.8	1.8	1.3	2.1	2.0	1.3
- Change in inventories	0.2	0.1	0.0	0.0	0.0	0.0	-0.2
- Net exports	-0.5	-0.1	0.0	0.0	0.0	0.1	0.0
Output gap[1]	-0.7	-0.9	-0.8	-0.8	-0.6	-0.3	-1.0
Employment (% change)	0.6	0.6	0.6	0.8	0.3	0.3	0.4
Unemployment rate (%)	5.3	4.9	5.0	5.1	4.9	4.9	5.1
Labour productivity (% change)	-0.5	1.2	1.3	0.5	1.7	1.8	0.7
HICP inflation (%)	1.6	n.a.	n.a.	0.9	n.a.	n.a.	1.2
GDP deflator (% change)	2.1	1.7	1.7	1.9	1.7	1.7	1.8
Comp. of employees (per head, % change)	1.9	2.6	2.7	2.8	3.1	3.5	3.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	7.0	6.8	7.1	7.1	6.5	7.0	7.1

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.

<u>Source</u>:

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The Draft Budgetary Plan confirms the target of a balanced general government budget in both 2014 and 2015 as projected in the Stability Programme. Despite the new measures reported in the Draft Budgetary Plan, no significant changes in relation to the Stability Programme are planned in terms of overall revenue and expenditure ratios in 2015. As regards individual revenue and expenditure categories, total tax revenue, social payments and interest expenditure are now projected to be lower by ½% of GDP each, which is expected to be offset by higher other revenue and expenditure. The higher ratio of gross fixed capital formation to GDP (by 1% of GDP) is largely due to the revised statistical recording of research and military expenditure, and is reflected in lower intermediate consumption. The Draft Budgetary Plan foresees a decrease in the (recalculated) structural balance[2] from 0.7% to 0.6% of GDP in 2014 and to 0.5% of GDP in 2015, which largely confirms the Stability Programme's projections. The Draft Budgetary Plan's targets for 2014 and 2015 are broadly in line with the Commission 2014 autumn forecast in terms of the headline budget balance and the structural balance as well as the composition of revenue and expenditure, also in view of broadly similar projections of a robust labour market that limits the adverse impact of the more pessimistic macroeconomic scenario of the Commission forecast on revenue and expenditure.

[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.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2013	2014			2015			Change: 2013-2015
	COM	SP[3]	DBP[3]	COM	SP[3]	DBP[3]	COM	DBP[3]
Revenue	**44.5**	**44½**	**44½**	**44.6**	**44**	**44**	**44.7**	**- 1/2**
of which:								
- Taxes on production and imports	10.8	11	11	10.7	11	10½	10.6	-0
- Current taxes on income, wealth, etc.	11.9	12½	12	12.0	12½	12½	12.1	1/2
- Capital taxes	0.2	0	0	0.2	0	0	0.1	-0
- Social contributions	16.6	16½	16½	16.5	16½	16½	16.6	-0
- Other (residual)	5.0	4 1/2	5	5.2	4	5	5.2	- 1/2
Expenditure	**44.3**	**44½**	**44**	**44.3**	**44**	**44**	**44.6**	**- 1/2**
of which:								
- Primary expenditure	42.3	42 1/2	42 1/2	42.5	42 1/2	42	42.9	-0
of which:								
Compensation of employees	7.7	7½	7½	7.7	7½	7½	7.8	-0
Intermediate consumption	4.7	5	4½	4.8	5	4½	4.8	-0
Social payments	23.7	24½	23½	23.8	24½	24	24.1	0
Subsidies	0.9	1	1	0.9	1	1	0.9	0
Gross fixed capital formation	2.2	1½	2½	2.3	1½	2½	2.4	0
Other (residual)	3.0	3	3	2.9	3	3	2.9	-0
- Interest expenditure	2.0	2	2	1.9	2	1½	1.8	- 1/2
General government balance (GGB)	**0.1**	**0**	**0**	**0.2**	**0**	**0**	**0.0**	**0**
Primary balance	**2.2**	**2**	**2**	**2.1**	**2**	**2**	**1.8**	**-0**
One-off and other temporary	0.0	-0	-0	0.0	-0	-0	0.0	0
GGB excl. one-offs	**0.2**	**0**	**0**	**0.3**	**0**	**1/2**	**0.0**	**0**
Output gap[1]	-0.7	-0.9	-0.8	-0.8	-0.6	-0.3	-1.0	0.6
Cyclically-adjusted balance[1]	0.6	0.6	0.6	0.7	0.4	0.4	0.6	-0.3
Structural balance (SB)[2]	**0.6**	**0.6**	**0.6**	**0.7**	**0.4**	**0.5**	**0.6**	**-0.3**
Structural primary balance[2]	2.6	2.6	2.4	2.6	2.2	2.1	2.4	-0.6

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission 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]The Stability Programme (SP) and the Draft Budgetary Plan (DBP) report revenue and expenditure targets rounded to half a percentage point of GDP.

Source:

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

3.2. Debt developments

The debt-to-GDP ratio decreased by 2.2% of GDP to 76.9% in 2013. The Draft Budgetary Plan projects a further diminishing debt-to-GDP ratio in 2014 and 2015 thanks to the balanced budget, the denominator effect of GDP growth and the on-going winding up of 'bad banks'. The debt level is now expected to be 2% of GDP lower in both years than planned in the Stability Programme, resulting in particular from an upward revision of GDP due to the new accounting standard ESA 2010 and a corresponding downward revision of the debt ratio for 2013. The Commission forecast projects the debt ratio to fall somewhat less strongly than in the Draft Budgetary Plan as it does not factor in potential gains from the winding up of 'bad banks'.

Table 3. Debt developments

(% of GDP)	2013	2014			2015		
		SP[3]	DBP[3]	COM	SP[3]	DBP[3]	COM
Gross debt ratio[1]	**76.9**	**76**	**74**	**74.5**	**72½**	**70½**	**72.4**
Change in the ratio	-2.2	-2½	-3	-2.4	-3	-3	-2.1
Contributions[2]:							
1. Primary balance	**2.2**	**-2**	**2**	**2.1**	**2**	**2**	**1.8**
2. "Snow-ball" effect	**0.3**	**-0.6**	**-0.8**	**-0.5**	**-0.9**	**-1.0**	**-0.3**
Of which:							
Interest expenditure	2.0	2	2	1.9	2	1 1/2	1.8
Growth effect	-0.1	-1.4	-1.4	-0.9	-1.5	-1.5	-0.8
Inflation effect	-1.6	-1.2	-1.2	-1.4	-1.2	-1.2	-1.3
3. Stock-flow adjustment	**-0.4**	**0**	**-0**	**0.3**	**- 1/2**	**-0**	**0.0**
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

[3] The Stability Programme (SP) and the Draft Budgetary Plan (DBP) report debt developments rounded to half a percentage point of GDP.

Source:

Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

3.3. Measures underpinning the draft budgetary plan

Compared to the Stability Programme, the Draft Budgetary Plan includes only the Act to enhance long-term care as additional fiscal measure for 2015. The contribution rate is planned to be increased by 0.3 pp. in order to finance additional expenditure on extended long-term care services. This is planned to have no major impact on overall revenue, expenditure and the budget balance[3]. Furthermore, the projections factor in a reduction in the pension contribution rate in 2015, which results from applying a semi-automatic rule mandated by law and reflects the pension insurance's currently favourable financial situation. Moreover, no significant one-off measures are foreseen in 2014 and 2015.

[3] Using fractions rounded to ½% of GDP, the Draft Budgetary Plan reports an annual budgetary impact of the Act to enhance long-term care of 0% of GDP on both revenue and expenditure over the period 2014 to 2016.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2014	**2015**	**2016**
Taxes on production and imports	n.a.	n.a.	n.a.
Current taxes on income, wealth,	n.a.	n.a.	n.a.
Capital taxes	n.a.	n.a.	n.a.
Social contributions	0.0	0	0
Property Income	n.a.	n.a.	n.a.
Other	n.a.	n.a.	n.a.
Total	0	0	0

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure. The figures are rounded to half a percentage point of GDP.
Source: Draft Budgetary Plan 2015

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2014	**2015**	**2016**
Compensation of employees	n.a.	n.a.	n.a.
Intermediate consumption	n.a.	n.a.	n.a.
Social payments	0	0	0
Interest Expenditure	n.a.	n.a.	n.a.
Subsidies	n.a.	n.a.	n.a.
Gross fixed capital formation	n.a.	n.a.	n.a.
Capital transfers	n.a.	n.a.	n.a.
Other	n.a.	n.a.	n.a.
Total	0	0	0

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure. The figures are rounded to half a percentage point of GDP.
Source: Draft Budgetary Plan 2015

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 budget deficit was below 3% of GDP in 2013 and is planned to remain so in 2014 and 2015, which is confirmed by the Commission 2014 autumn forecast.

Germany is in the transition period as regards the debt criterion for three years starting from 2012. This implies that, during this period, it is required to make sufficient progress towards compliance with the debt criterion and comply with the debt benchmark at the end of the transition period. The Draft Budgetary Plan does not include sufficient information to assess compliance with the transitional arrangements of the debt benchmark. Based on the Commission 2014 autumn forecast, the debt benchmark is expected to be met at the end of the transition period in 2014, and the debt benchmark is expected to be respected in 2015.

Table 6. Compliance with the debt criterion*

	2014		2015	
	DBP	**COM**	**DBP**	**COM**
Gap to the debt benchmark [1,2]	n.r.	n.r.	n.a.	-5.1
Structural adjustment [3]	-0.1	0.1		
To be compared to:				
Required adjustment [4]	-4.4	-3.7		

Notes:

[1] 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.

[2] 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.

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

[4] 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 (DBP) budgetary projections for the previous years are achieved and that GDP growth follows COM (DBP) forecast.

Source :
Stability programme 2014 (SP); Draft Budgetary Plan 2015 (DBP); Commission 2014 autumn forecast (COM); Commission calculations.

* An ex-ante assessment of planned compliance with the debt criterion can be assessed based on the DBP only for the concerned countries providing extended data series in the DPB on a voluntary basis, as agreed at the EFC-A on 22 September.

Germany registered a structural surplus of 0.6% of GDP in 2013, compared with its medium-term objective of a structural deficit not exceeding 0.5% of GDP, and thus overachieved the medium term objective. According to the information provided in the Draft Budgetary Plan, with a structural surplus of 0.6% and 0.5% of GDP, respectively, Germany is expected to

overachieve its medium-term objective also in 2014 and 2015, which is confirmed by the Commission 2014 autumn forecast.

On the basis of this assessment, Germany is expected to comply with the recommendation related to the requirements of the Stability and Growth Pact addressed to it by the Council on 8 July 2014 (Box 2).

Box 2. Council recommendations addressed to Germany

On 8 July 2014, 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 pursue growth-friendly fiscal policy and preserve a sound fiscal position, ensuring that the medium-term budgetary objective continues to be adhered to throughout the period covered by the Stability Programme and that the general government debt ratio remains on a sustained downward path; in particular, use the available scope for increased and more efficient public investment in infrastructure, education and research; improve the efficiency of the tax system, in particular by broadening the tax base, in particular on consumption, by reassessing the municipal real estate tax base, by improving the tax administration and by reviewing the local trade tax, also with a view to foster private investment; make additional efforts to increase the cost-effectiveness of public spending on healthcare and long-term care; ensure the sustainability of the public pension system by (i) changing the financing of new non-insurance/extraneous benefits (*'Mütterrente'*) to funding from tax revenues, also in order to avoid a further increase of social security contributions, (ii) increasing incentives for later retirement, and (iii) increasing the coverage in second and third pillar pension schemes; complete the implementation of the debt brake consistently across all *Länder*, ensuring that monitoring procedures and correction mechanisms are timely and relevant; improve the design of fiscal relations between the federation, *Länder* and municipalities also with a view to ensuring adequate public investment at all levels of government; improve conditions that further support domestic demand, inter alia by reducing high taxes and social security contributions, especially for low-wage earners; and take measures to reduce fiscal disincentives to work, in particular for second earners, and facilitate the transition from mini-jobs to forms of employment subject to full mandatory social security contributions.

Table 7. Compliance with the requirements of the preventive arm

(% of GDP)	2013	2014		2015	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	0.6	0.7		0.6	
Structural balance based on freezing (COM)	0.7	0.9		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2013**	**2014**		**2015**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.0	0.0		0.0	
Change in structural balance[5]	0.4	-0.1	0.1	-0.2	-0.1
One-year deviation from the required adjustment after considering the relevant factors[6]	1.1	1.1	1.3	1.2	1.3
Two-year average change in structural balance[5]	0.8	0.1	0.2	-0.1	0.0
Two-year average deviation from the required adjustment after considering the relevant factors[6]	0.9	1.1	1.2	1.1	1.3
Expenditure benchmark pillar					
Applicable reference rate[7]	1.2	1.1		1.1	
One-year deviation[8] *Two-year average deviation*[8]	n.a. (structural balance above the MTO)				
Conclusion					
Conclusion over one year Conclusion over two years	Compliance				

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between Spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 28.).

[5] Change in the structural balance compared to year t-1. Ex post assessment (for 2013) is carried out on the basis of Commission 2014 spring forecast.

[6] The difference of the change in the structural balance and the required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[7] 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.

[8] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source:

Draft Budgetary Plan 2015 (DBP), Commission 2014 autumn forecast (COM), Commission calculations

5. IMPLEMENTATION OF FISCAL-STRUCTURAL REFORMS

The Draft Budgetary Plan refers to a number of fiscal-structural reform measures that were already included in the Stability Programme and the National Reform Programme, including increased infrastructure investment, further development of the heavy goods vehicle toll, higher spending on education and research, further development of the High Tech Strategy, an Act to enhance preventive healthcare, a review of fiscal relations between the different layers of government, initiatives to fight tax evasion, the rise in the basic income tax allowance and the suspension of the regular reduction of the pension contribution rate at the beginning of this year. Furthermore, the Draft Budgetary Plan specifies reforms of long-term care and of the financing structure of the healthcare insurance, which aim to address the country-specific recommendation to increase the cost-effectiveness of public spending in these areas, but these measures could also further raise the tax wedge (see Box 3). This has been complemented by plans to use more flexibly funds for infrastructure investment and a higher share of existing funds to strengthen bridges and improve inland connections to seaports, to further develop infrastructure funding through public private partnerships, and to enhance cooperation between the federation and the *Länder* in the area of science and research. However, these plans do not appear to be sufficiently specified and ambitious in view of the additional annual investment of ½ to 1 % of GDP for the public sector as a whole over the coming years that the in-depth review of the German economy identified as necessary to maintain and modernise public infrastructure and remove specific bottlenecks[4].

Box 3. Addressing the tax wedge

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed its commitment to effectively reduce the tax burden on labour. It will take stock of Member States' plans for reductions of the tax burden when discussing the Draft Budgetary Plans.

In the context of the European Semester, Germany was issued the recommendations to "improve conditions that further support domestic demand, inter alia by reducing high taxes and social security contributions, especially for low-wage earners" and to "take measures to reduce fiscal disincentives to work, in particular for second earners, and facilitate the transition from mini-jobs to forms of employment subject to full mandatory social security contributions."

The tax wedge in Germany is well above the EU average. The tax wedge for a single person without children earning 50% of the average wage was 42.1% compared to an EU average of 34% in 2013; 45.1% (EU average: 37.7%) for 67% of the average wage; and 49.3% (EU average: 41.1%) for the average wage[5]. While the overall employment rate is well above the EU average, the average number of hours worked per worker is the second lowest in the EU.

Germany's Draft Budgetary Plan contains the plan to increase the long-term care contribution rate by 0.3 pp. with a view to financing extended care services and a reserve fund that will be set up to mitigate future increases in the contribution rate. While the reform may enhance the cost-effectiveness of long-term care as it also aims to promote the use of out-patient benefits and services, the increase in the contribution rate will add to the tax wedge. The Draft

[4] European Commission (2014), Macroeconomic imbalances - Germany 2014, European Economy, Occasional Papers, No 174.

[5] The arithmetic average is used to calculate the average tax wedge for the EU; recent data for Cyprus and Croatia are not available; data from 2012 were used for Bulgaria, Latvia, Lithuania, Malta and Romania.

Budgetary Plan also refers to the already adopted Act to enhance financial structures and quality in the statutory health insurance, which reduces the contribution rate for employees from 8.2 % currently to 7.3 % as of January 2015, the same rate that applies to employers. In turn, individual health insurers will be allowed to raise extra, income-based supplementary premiums from employees. The Act is expected to stimulate competition among insurers, which may enhance efficiency and result in somewhat lower contributions by employees in the short term. However, future cost increases in healthcare could again put pressure on the tax wedge, in particular for low-wage earners, as the new premiums will continue to be income-based rather than flat-rate contributions combined with compensation for low-income earners through the tax system, as provided for under the 2011 health reform. Earlier this year, the increase in the basic income tax allowance slightly reduced the tax wedge, while the federal government decided not to reduce the pension contribution rate from 18.9 % to 18.3 %, as initially planned, with a view to financing additional benefits and early retirement options for certain groups of pensioners.

6. OVERALL CONCLUSION

Germany has a balanced budget and, according to the Commission 2014 autumn forecast, will meet the debt benchmark at the end of the transition period in 2014 as well as in 2015. Germany overachieved its medium-term objective in 2013 and, according to both the information provided in the Draft Budgetary Plan and the Commission forecast, will continue to do so in 2014 and 2015.

The Draft Budgetary Plan includes reforms which aim to address the country-specific recommendation to increase the cost-effectiveness of public spending on healthcare and long-term care, but these reforms could also further increase the tax wedge. Other plans, in particular to foster investment in public infrastructure, do not appear to be sufficiently specified and ambitious. In fact, given the sizeable fiscal space, the investment needs and the very low interest rates, which imply that the social returns largely outweigh the borrowing costs, significantly reinforced efforts to boost public investment are warranted.