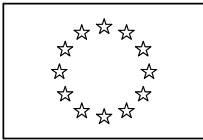

EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 31 March 2010
ECFIN/F2 Ares(2010)171525 EN

GERMANY: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE FEBRUARY 2010 UPDATE OF THE STABILITY PROGRAMME

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called 'stability programme' for countries that have adopted the euro as their currency and 'convergence programme' for those that have not. The most recent update of Germany's stability programme was submitted on 9 February 2010.

The attached technical analysis of the programme prepared by the staff and under the responsibility of the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission was finalised on 17 March 2010. Comments should be sent to: Carsten Eppendorfer (carsten.eppendorfer@ec.europa.eu), Karolina Leib (karolina.leib@ec.europa.eu)a and Norbert Wunner (norbert.wunner@ec.europa.eu). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services' autumn 2009 forecast, (ii) the code of conduct ("Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 10 November 2009) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

Based on this analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 17 March 2010. The ECOFIN Council is expected to discuss the opinion on the programme on 16 April 2010.

* * *

All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

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

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1. INTRODUCTION

This document assesses the February 2010 update of the Germany's stability programme, which was submitted on 9 February 2010 and covers the period 2009-2013. The programme builds on the 2010 budget proposal. It was approved by the government and presented to the competent committees of the German *Bundestag* and *Bundesrat*.

This assessment is structured as follows. Section 2 discusses the key challenges for public finances in Germany. Section 3 assesses the plausibility of the macroeconomic scenario underpinning the public finance projections of the stability programme against the background of the Commission services' economic forecasts[1]. Section 4 analyses budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy. It also assesses risks attached to the budgetary targets. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses institutional features of public finances. Finally, Section 7 concludes with an overall assessment of the programme. The annex provides a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme.

1 This assessment uses the Commission services' 2009 autumn forecast, as published on 3 November 2009, as a benchmark. However, more recent information that has become available has also been taken into account to assess the risks to the programme scenarios.

Table 1. Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012	2013
Real GDP (% change)	**SP Jan 2010**	**1.3**	**-5.0**	**1.4**	**2**	**2**	**2**
	COM Nov 2009	1.3	-5.0	1.2	1.7	n.a.	n.a.
	SP Jan 2009	*1.3*	*-2.3*	*1¼*	*1¼*	*1¼*	*n.a.*
HICP inflation (%)	**SP Jan 2010**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
	COM Nov 2009	2.8	0.3	0.8	1.0	n.a.	n.a.
	SP Jan 2009	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*
Output gap[1] (% of potential GDP)	**SP Jan 2010**	**3.2**	**-2.6**	**-2.1**	**-1.3**	**-1.1**	**-0.9**
	COM Nov 2009[2]	3.0	-2.9	-2.6	-2.2	n.a.	n.a.
	SP Jan 2009	*2.2*	*-0.9*	*-0.7*	*-0.7*	*-1.0*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Jan 2010**	**6.6**	**4.5**	**4.9**	**5.0**	**5½**	**5½**
	COM Nov 2009	6.6	4.0	3.8	3.7	n.a.	n.a.
	SP Jan 2009	*7.1*	*7.0*	*7*	*7*	*7*	*n.a.*
General government revenue (% of GDP)	**SP Jan 2010**	**43.7**	**44.4**	**42½**	**42**	**42**	**42**
	COM Nov 2009	43.7	44.6	43.3	42.9	n.a.	n.a.
	SP Jan 2009	*44*	*43½*	*42½*	*42½*	*43*	*n.a.*
General government expenditure (% of GDP)	**SP Jan 2010**	**43.7**	**47.6**	**48**	**47**	**46**	**45**
	COM Nov 2009	43.7	48.0	48.3	47.5	n.a.	n.a.
	SP Jan 2009	*44*	*46½*	*46½*	*45½*	*45½*	*n.a.*
General government balance (% of GDP)	**SP Jan 2010**	**0.0**	**-3.2**	**-5½**	**-4½**	**-3½**	**-3**
	COM Nov 2009	0.0	-3.4	-5.0	-4.6	n.a.	n.a.
	SP Jan 2009	*-0*	*-3*	*-4*	*-3*	*-2½*	*n.a.*
Primary balance (% of GDP)	**SP Jan 2010**	**2.7**	**-0.6**	**-3**	**-2**	**-½**	**½**
	COM Nov 2009	2.7	-0.6	-2.2	-1.7	n.a.	n.a.
	SP Jan 2009	*2½*	*-0*	*-1*	*-0*	*½*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**SP Jan 2010**	**-1.6**	**-1.9**	**-4.4**	**-4.1**	**-3.1**	**-2.3**
	COM Nov 2009	-1.5	-1.9	-3.6	-3.5	n.a.	n.a.
	SP Jan 2009	*-1.2*	*-2.4*	*-3.5*	*-2.4*	*-2.1*	*n.a.*
Structural balance[3] (% of GDP)	**SP Jan 2010**	**-1.2**	**-1.8**	**-4.4**	**-3.9**	**-3.0**	**-2.3**
	COM Nov 2009	-1.1	-1.9	-3.6	-3.5	n.a.	n.a.
	SP Jan 2009	*-0.8*	*-2.5*	*-3.4*	*-2.4*	*-2.1*	*n.a.*
Government gross debt (% of GDP)	**SP Jan 2010**	**65.9**	**72½**	**76½**	**79½**	**81**	**82**
	COM Nov 2009	65.9	73.1	76.7	79.7	n.a.	n.a.
	SP Jan 2009	*65½*	*68½*	*70½*	*71½*	*72½*	*n.a.*

Notes:

[1]Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2]Based on estimated potential growth of 1.0%, 0.7%, 0.9% and 1.2% respectively in the period 2008-2011.

[3]Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.4% of GDP in 2008 and 0.1% of GDP in 2009 deficit-increasing according to the most recent programme and 0.3% of GDP in 2008 deficit-increasing according to Commission services' November 2009 forecast. There are no one-offs and other temporary measures for years 2010-2013 according to the most recent programme and for years 2009-2011 according to Commission services' autumn 2009 forecast.

Source:
Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations.

2. KEY CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE

This section describes recent economic and budgetary developments for Germany, which form the background against which the current programme assessment should be viewed, and outlines the key challenges to be addressed by future economic policies.

Given its large export-oriented manufacturing sector and its specialisation in investment goods, Germany was heavily exposed to the global trade shock triggered by the global financial crisis. On the back of a sharp, unprecedented drop in exports and investment, real GDP contracted by almost 7% y-o-y in the first quarter of 2009. However, driven by expansionary monetary and fiscal policies, a turnaround in the inventory cycle and a rebound of world trade, the German economy bounced back strongly in the second and third quarter of 2009, before the recovery lost momentum in the final quarter as domestic

demand weakened. The labour market remained remarkably resilient during the recession so far, with the unemployment rate edging up by only ½ pp. since mid-2008, partly reflecting working-time reductions and state-funded short-time working arrangements. The German banking sector suffered heavy losses and write-downs from investments in international financial markets, which weakened the capital base of many financial institutions. Bank balance sheets may be further burdened by a rise in credit defaults triggered by the recession, which could also impair the ability of banks to provide financing to the corporate and household sector and could undermine the incipient economic recovery.

In response to the crisis, the German government adopted a set of measures to stabilise the banking sector, including the provision of guarantees of up to EUR 400 bn (around 16% of GDP) via a Financial Market Stabilisation Fund. An additional EUR 80 bn (around 3% of GDP) was earmarked for capital injections and purchasing of troubled assets. A "bad bank" scheme was introduced to remove impaired assets from bank balance sheets. Moreover, apart from letting the automatic stabilisers fully operate, Germany also introduced sizeable fiscal stimulus measures in 2009 and 2010 in line with the European Economic Recovery Plan (EERP), which aimed at income support, public and private investment, ensuring access to finance, avoiding lay-offs and improving access to training. As a result of these discretionary measures as well as crisis-related revenue shortfalls and higher expenditures, the general government budget has shifted from a balanced position in 2008 to a deficit of above 3% of GDP in 2009. On the basis of the planned figures for the deficit and debt in 2009 reported in the July 2009 EDP notification, the excessive deficit procedure (EDP) for Germany was opened on 2 December 2009 with the Council setting a deadline of 2013 for the correction of the excessive deficit (see Box 1 in Section 4.1).

In the medium term, the recovery of the German economy should be supported by the fact that it has already gone through major structural adjustments in the 2000s. Moderate wage growth helped restore cost competitiveness, which together with buoyant external demand contributed to the emergence of a sizeable current account surplus. Household and corporate balance sheets were strengthened by higher net lending, while labour market reforms contributed to reducing structural unemployment. However, stabilising the banking sector and ensuring access to finance for the non-financial sector will be critical to restore growth. Further strengthening the adjustment capacity of the labour market will be important to prevent the still expected cyclical increase in unemployment from turning into higher structural unemployment. A key challenge will be to reconcile the necessary fiscal consolidation with raising the economy's long-term growth potential, in particular by strengthening domestic sources of growth and through further reforms in the areas of competition in services, labour market integration and education and training.

3. MACROECONOMIC OUTLOOK

Against the background of the current macroeconomic situation and the main policy challenges set out in the previous section, this section makes an assessment of the plausibility of the macroeconomic scenario underpinning the public finance projections of the programme.

As presented in Table 2, the macroeconomic scenario underlying the programme envisages that after a slump of 5% in 2009, real GDP growth will be restored, moving

from 1.4% in 2010 to an average rate of 2% over the rest of the programme period.[2] The recovery in 2010 is expected to be predominantly export-driven, while gross fixed capital formation and public consumption also contribute to growth, supported by ongoing fiscal stimulus measures. In contrast, private consumption is projected to contract in 2010, reflecting partly a backlash from the expiry of the car scrapping scheme. Additional household relief taking effect in 2010 will, however, help limit the impact of the crisis on disposable income and private consumption. From 2011 onward, economic growth would be more broadly based with the growth contribution from domestic demand even exceeding the contribution from net exports. Employment is envisaged to contract markedly in 2010 in response to the recession and to grow by ½% per year from 2011 onward, in line with the projected recovery. This would not be fully reflected, though, in the development of unemployment, which after an initial hike 2010 would decline only moderately in 2011 and then remain unchanged, assuming higher participation rates to compensate the rise in employment. Inflation would pick up moderately over the programme period, with the growth rate of the private consumption deflator rising from 0.1% in 2009 to 1½% from 2011 onward. Real wage growth is expected to remain broadly in line with productivity developments.

Cyclical conditions (as measured by the output gap recalculated by the Commission services based on the data provided in the programme following the commonly agreed methodology) show a gradual decline in the large negative output gap from around 2½% of potential output in 2009 to around 1% of potential output at the end of the programme period. The (recalculated) output gap in the programme is slightly less negative than the one estimated in the Commission services' autumn forecast and is projected to close somewhat faster. The reasons for this divergence are marginally higher potential growth estimates in the Commission services' forecast and the higher growth projections in the programme for 2010 and 2011.

Real GDP growth projections in the programme are around ¼ pp. higher than in the Commission services' autumn forecast for 2010 and 2011. While growth projections for 2012 and 2013 are also above the Commission services' estimate of average potential growth for the period 2009-2011, they do imply only a gradual closure of the output gap. Regarding the composition of growth, the programme expects stronger exports and weaker private consumption in 2010 than the Commission services' autumn forecast, which is consistent with recent developments. Differences regarding the growth composition in 2011 are minor, even though the programme envisages a somewhat stronger expansion of private consumption. This reflects a more favourable outlook in the programme in 2010 and 2011 for employment growth, unemployment and partly also wages, which can be justified by the stronger-than-expected resilience of the German labour market so far and which is consistent with higher real GDP growth projections. However, the downscaling of short-time work programmes especially after 2010 and a more protracted economic recovery could entail a stronger, delayed reaction of the labour market to the crisis than envisaged in the programme. Assessed against currently available information[3], the macroeconomic scenario therefore appears to be based on somewhat favourable growth assumptions.

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[2] The programme provides only limited information about the external assumptions underlying these projections. The assumptions regarding world growth and world trade for 2010 as well as oil price and exchange rates for the programme period appear, however, to be largely in line with the common external assumptions of the Commission services' autumn forecast.

[3] The assessment notably takes into account the Commission services' autumn 2009 forecast, but also other information that has become available since then, including the Commission services' February 2010 interim forecast.

Table 2: Comparison of macroeconomic developments and forecasts

	2009		2010		2011		2012	2013
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	-5.0	-5.0	1.2	1.4	1.7	2	2	2
Private consumption (% change)	0.6	0.4	-0.2	-0.5	0.8	1	1	1
Gross fixed capital formation (% change)	-8.9	-8.6	2.1	2.1	3.9	4	4	4
Exports of goods and services (% change)	-15.4	-14.7	2.6	5.1	4.7	3	3	3
Imports of goods and services (% change)	-9.5	-8.9	2.0	3.4	4.3	2½	2½	2½
Contributions to real GDP growth:								
- Final domestic demand	-0.9	-0.9	0.6	0.5	1.4	1½	1½	1½
- Change in inventories	-0.7	-0.8	0.3	0.1	0.0	0	0	0
- Net exports	-3.4	-3.4	0.3	0.8	0.3	½	½	½
Output gap[1]	-2.9	-2.6	-2.6	-2.1	-2.2	-1.3	-1.1	-0.9
Employment (% change)	-0.3	-0.1	-1.8	-1.0	-0.3	½	½	½
Unemployment rate (%)	7.7	7.6	9.2	8.3	9.3	8	8	8
Labour productivity (% change)	-4.6	-4.9	3.1	2.4	2.0	1½	1½	1½
HICP inflation (%)	0.3	n.a.	0.8	n.a.	1.0	n.a.	n.a.	n.a.
GDP deflator (% change)	0.9	1.4	0.6	0.6	0.5	1	1	1
Comp. of employees (per head, % change)	-0.2	0.0	1.3	0.9	1.6	2	2	2
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	4.0	4.5	3.8	4.9	3.7	5.0	5½	5½

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

Source :

Commission services' autumn 2009 forecasts (COM); Stability programme (SP).

4. GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first three parts discuss the budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy in the programme. The final part analyses the risks attached to the budgetary targets.

4.1. Budgetary implementation in 2009

According to the programme, after a balanced position in 2008, the general government budget fell into a deficit of 3.2% of GDP[4], which is broadly in line with the Commission services' autumn forecast (3.4% of GDP). The widening of the deficit was mainly due to automatic stabilisers that were allowed to operate fully (around 3% of GDP[5]) and a wide range of expansionary measures adopted by the German authorities in line with the EERP to counter the economic downturn. Benefiting from a balanced budgetary position in 2008, Germany was able to introduce measures to stabilise financial markets and a sizeable fiscal stimulus (around 1¾% of GDP in 2009 and around ¾% of GDP for 2010[6]). The 2009 deficit was affected by the one-off measures amounting to -0.1% of GDP that nevertheless masks the positive impact on the revenue side (0.1% of GDP) and the negative on the expenditure side (-0.2% of GDP)[7]. The previous programme projected a slightly lower deficit of 3% of GDP.

[4] According to the latest official estimate, the general government deficit in 2009 amounted to 3.3% of GDP. See Federal Statistical Office, Press release No.062 / 2010-02-24, available at: http://www.destatis.de/jetspeed/portal/cms/Sites/destatis/Internet/EN/press/pr/2010/02/PE10__062__813,templateId=renderPrint.psml

[5] Commission services' calculations on the basis of the information included in the programme.

[6] Commission services' estimations on the year-on-year basis.

[7] Commission services' estimations.

Table 3 compares the projected outcome for the general government balance, revenue and expenditure (as a percentage of GDP) in 2009 as presented in the new stability programme with the targets from the previous update of the programme. Differences between outcome and targets (excluding the impact of an unanticipated GDP developments which may have affected the ratio, referred to as the 'denominator effect') are decomposed in the impact of a different starting position (i.e. the outcome of 2008 may also have been different from what was anticipated in the previous programme update) and the impact of differences in the revenue/expenditure growth rate from the planned growth rates[8].

Table 3: Budgetary implementation in 2009

	2008		2009	
	Planned **SP Jan 2009**	**Outcome** **SP Jan 2010**	**Planned** **SP Jan 2009**	**Outcome** **SP Jan 2010**
Government balance (% of GDP)	-0.1	0.0	-3	-3.2
Difference compared to target [1]	0.1		-0.3	
Difference excluding denominator effect [1,2]			**-0.4**	
Of which: due to a different starting position end 2008			0.1	
due to different revenue / expenditure growth in 2009			-0.4	
p.m. Residual [3]			-0.1	
p.m. Nominal GDP growth (planned and outcome)			*-0.2*	*-3.7*
Revenue (% of GDP)	43.9	43.7	43½	44.4
Revenue surprise compared to target [1]	-0.2		0.9	
Revenue surprise excluding denominator effect [1,2]			**-0.7**	
Of which: due to a different starting position end 2008			-0.2	
due to different revenue growth in 2009			-0.5	
p.m. Residual [3]			0.0	
p.m. Revenue growth rate (planned and outcome)			*-1.1*	*-2.2*
Expenditure (% of GDP)	44.0	43.7	46½	47.6
Expenditure surprise compared to target [1]	0.3		-1.3	
Expenditure surprise excluding denominator effect [1,2]			**0.3**	
Of which: due to different starting position end 2008			0.3	
due to different expenditure growth rate in 2009			0.1	
p.m. Residual [3]			-0.1	
p.m. Expenditure growth rate (planned and outcome)			5.0	4.9

Notes:

[1] A positive number implies that the outcome was better (in terms of government balance) than planned.

[2] The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue and expenditure separately, on the balance they usually largely cancel against each other.

[3] The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.

Source: Commission services

After controlling for the denominator effect, the slightly worse than expected outcome in 2009 was primarily driven by the negative revenue surprises of around ¾% of GDP that were not compensated for by the lower-than-anticipated expenditure growth amounting to around ¼% of GDP. The negative revenue surprises can be primarily attributed to tax revenue shortfalls of ½% of GDP related to lower-than-expected revenues from profit-

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[8] Mathematically, the difference in the revenue ratio in Table 3 can be expressed as:

$$\rho^o - \rho^p = \underbrace{\frac{1+r^p}{1+g^p}\Delta\rho_{-1}}_{\text{Base effect}} + \underbrace{\frac{\rho^o_{-1}}{(1+g^o)(1+g^p)}\Delta r}_{\text{Revenue growth effect}} - \underbrace{\frac{\rho^o_{-1}}{(1+g^o)(1+g^p)}\Delta g}_{\text{Denominator effect}} + \underbrace{\frac{\rho^o_{-1}(r^o g^p - r^p g^o)}{(1+g^o)(1+g^p)}}_{\text{Residual}}$$

where r is the growth rate of revenue and g is the growth rate of GDP. The subscript -1 refers to the previous year's value. Superscripts o and p refer to the outcome and the planned value respectively. Similar for the expenditure ratio.

related taxes in 2009 and to a lesser extent to the worse starting position at the end of 2008 (¼% of GDP), despite the favourable GDP composition effect observed both in 2008 and 2009[9]. The slump in GDP in the second half of 2008 had a relatively contained impact on tax revenues. GDP contraction was mainly driven by a dramatic fall in exports which is considered to be less tax-rich. The labour market remained remarkably robust both at the end of 2008 and throughout 2009, which allowed for some expenditure savings. Weaker-than-planned expenditure growth benefited also from lower interests payments owing to prevailing low interest rates. The positive expenditure surprise occurred despite an unexpected spending-increasing one-off measure related to bank rescue operations (-0.1% of GDP) which was not yet included in the Commission services' autumn 2009 forecast.

The actual budgetary results in 2009 were neither significantly affected by the direct effects of the financial crisis nor by the one-off measures (-0.1% of GDP).

Box 1: The excessive deficit procedure (EDP) for Germany

On 2 December 2009 the Council adopted a decision stating that Germany had an excessive deficit in accordance with Article 104(6) of the Treaty establishing the European Community (TEC). At the same time, the Council addressed a recommendation under Article 104(7) specifying that the excessive deficit had to be corrected by 2013.

In particular, Germany was recommended to implement the fiscal measures in 2010 as envisaged and, starting consolidation in 2011, put an end to the excessive deficit situation by 2013. The recommendations called for an average annual fiscal effort of at least 0.5% of GDP over the period 2011-2013, which should also contribute to bringing the government gross debt ratio back on a declining path that approaches the reference value at a satisfactory pace by restoring an adequate level of the primary surplus. Germany was also recommended to specify the measures that are necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than expected. In addition, Germany should seize any opportunity beyond the fiscal efforts, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the reference value. The Council established the deadline of 2 June 2010 for the German government to take effective action to implement the fiscal measures in 2010 as envisaged and to outline in some detail the consolidation strategy necessary to progress towards the correction of the excessive deficit. Finally, the German authorities should report on progress in the implementation of these Recommendations in a separate chapter in the updates of the stability programmes which will be prepared between 2010 and 2013.

4.2. The programme's budgetary strategy for 2010

The general government budget deficit is projected to increase by around 2¼% of GDP to 5½% of GDP in 2010. The further widening of the deficit is mainly fuelled by fiscal stimulus measures and to a lesser extent by the impact of automatic stabilisers let to operate freely (around ¼% of GDP)[10]. General government revenue is projected to shrink by almost 2% of GDP on the back of household relief measures (such as tax deductibility of health-care and long-term-care contributions, reduced contribution rate to health-care insurance, increased child allowance and higher basic personal allowance) as well as weaker domestic demand. The projected increase in general government expenditure by around ½% of GDP can be mainly attributed to the worsening situation on the labour market and continued investment in public infrastructure undertaken as a part of the fiscal stimulus.

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[9] The composition effect captures the fact that tax bases do not develop in accordance with the nominal GDP growth. Commission services estimates.

[10] Commission services' y-o-y calculations based on the information in the programme.

The draft federal budget for 2010 has been presented for the first reading in the *Bundestag* on 19-22 January 2010 and is scheduled to be approved by the *Bundestag* and by the *Bundesrat* by the end of March 2010. In 2010, the federal deficit target, for the Federal government and the special funds[11], is projected at around 3½% of GDP. The widening of the federal deficit will still be driven to a great extent by the fiscal stimulus measures, e.g. the planned infrastructure investments that are administered and disbursed as apart of a special Investment and Repayment Fund (*Investitions- und Tilgungsfonds*)[12]. The deficit of the aggregated budgets of the state and local government is projected to widen to 2% of GDP mainly on the back of substantial crisis-related revenue losses and investment expenditure resulting from the undertaken stimulus measures. The budgets of the social security systems are forecast to be almost balanced (-0% of GDP)[13]. This is only achieved thanks to the federal government subsidies to statutory health-care insurance (around ¾% of GDP in 2010, incl. a ¼% of GDP one-off additional transfer to compensate for the crisis-related revenue shortfalls[14]) and to the unemployment insurance (around ¾% of GDP in 2010[15]).

In 2010, major measures in the general government budget include the response to the economic crisis as adopted in the two last stimulus packages: (1) the package of 27 January 2009 (*Konjunkturpaket II*) and (2) the Act to Accelerate Economic Growth (*Wachstumsbeschleunigungsgesetz*) of 22 December 2009. The programme specifies in more details the measures related to the economic recovery packages, estimating the overall relief for the citizens and companies due to the tax measures agreed during the previous and the current legislature as of 2010 at over €24 bn (around 1% of GDP).

The course of fiscal policy in 2010 will remain strongly expansionary, with the structural deficit – as recalculated by the Commission services' on the basis of the information in the programme according to the commonly agreed methodology – projected to increase by around 2½% of GDP. There exists, however, a difference between the calculation of the change in the structural deficit by means of the bottom-up approach based on the information on the discretionary measures undertaken in 2010 (around 1¾% of GDP according to the Commission services' estimate) and the above described top-down approach according to the commonly agreed methodology. To this end, the widening of the (recalculated) structural deficit should be considered in view of the following two factors.

First, the German government still simulates the economy in 2010 with new fiscal measures amounting to around ¾% of GDP. While some of the stimulus measures undertaken in 2009 have already expired at the end of 2009 (e.g. car scrapping premium (¼% of GDP)), others are still continued in 2010 and they may even have a higher budgetary impact in 2010 than in 2009. For example, the reduced contribution rate to the health-care insurance, initially introduced as of mid-2009, will unfold its full impact only in the succeeding year (around ¼% of GDP). Moreover, some measures will come into effect with a lag, e.g. additional infrastructure investment in 2010 (around ¼% of GDP).

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[11] Federal Railways 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).

[12] According the programme, its debt will be repaid in future years with part of the German Central Bank (*Bundesbank)* profits.

[13] According to the Commission services' calculations, the share of the federal government level in total government expenditure is about 19%; of the regional and local governments around 37½% and of the social insurance around 43½%.

[14] Information provided in the programme.

[15] According to the 2010 draft federal budget (1 January 2010).

Second, the widening of the structural deficit is also likely to be fuelled by tax revenue losses resulting from a negative composition effect. This effect captures the fact that private consumption (tax base for indirect taxes) is falling in 2010 in real terms and gross wages and salaries (tax base for direct taxes on households and social contributions) are stagnating in nominal terms in 2010. Moreover, important revenue losses are likely to occur with respect to profit-related taxes that are still to be affected by the unfavourable developments of 2009.

As the 2010 budgetary target of -5½% of GDP does not rely on any further major measures additional to those that were already known at the time of the country's latest examination under the EDP procedure, it is, taken at face value, in line with the Council EDP recommendation to "implement the fiscal measures in 2010 as envisaged".

Table 4. Main budgetary measures for 2010

Revenue measures[1]	Expenditure measures[2]
Income support, incl. raising basic personal allowance (-0.1% of GDP)[3] Tax deductibility of health-care and long-term care contributions (-0.3% of GDP)[4] Support to private investment, incl. more favourable depreciation rules; reduced VAT rate of 7% for accommodation provision (-0.1% of GDP)[5]	Increased child allowance (*Kinderfreibetrag*) and child benefit (*Kindergeld*) (-0.2% of GDP)[5]

Notes:

[1] Estimated impact on general government revenue
[2] Estimated impact on general government expenditure
[3] Act to Ensure Employment and Stability in Germany (*Konjunkturpaket II*) of 2 March 2009
[4] Citizens' Relief Act (*Bürgerentlastungsgesetz*) of 16 July 2009
[5] Act to Accelerate Economic Growth (*Wachstumsbeschleinigungsgesetz*) of 22 December 2009

Source: Commission services and the Federal Ministry of Finance

4.3. The programme's medium-term budgetary strategy

This section describes the medium-term budgetary strategy outlined in the programme as well as the composition of the budgetary adjustment, including the broad measures envisaged.

Germany's goal over the medium-term is to achieve a general government budget close to balance in structural terms (cyclically adjusted net of one-off and other temporary measures). According to the programme, this implies a medium-term objective (MTO) of -½% of GDP which results from using the new calculations modalities that take into account ageing costs (see Box 2). However, the programme does not mention a target year for achieving the MTO. The main goal of the presented medium-term strategy is to correct the excessive deficit by 2013 with an average annual correction of the structural deficit of almost ¾% of GDP between 2011 and 2013, which is in line with the Council Recommendation under Article 126(7) of 2 December 2009.

As presented in Table 5, the programme projects the general government balance to improve from 2011 onwards. In nominal terms, the consolidation is expected to take place in equal steps in 2011 and 2012 – around 1 percentage point each – followed by a smaller adjustment of around ½ percentage point in 2013. This leads to the correction of

the excessive deficit by 2013, i.e. by the deadline established by the Council Recommendation under Article 126(7) of 2 December 2009. Budgetary targets, taken at face value, are in line with the Council EDP recommendations, but the projected consolidation is not underpinned by any concrete measures.

Box 2: The medium-term objective (MTO) for Germany

As noted in the Code of Conduct[16], the MTO aims to (a) provide a safety margin with respect to the 3% of GDP deficit limit; (b) ensure rapid progress towards fiscal sustainability; and (c) allow room for budgetary manoeuvre, in particular taking into account the needs for public investment. The MTO is defined in cyclically adjusted terms, net of one-off and other temporary measures. On 7 July 2009, the ECOFIN Council took note of a new methodology for setting MTOs, ensuring that implicit liabilities (costs related to ageing populations, in particular projected healthcare and pension expenditure) are also accounted for.

Specifically, the country-specific MTOs should take into account three components: (i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; (ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and (iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure. This implies a partial frontloading of the budgetary cost of ageing irrespective of the current level of debt. In addition to these criteria, MTOs should provide a safety margin with respect to the 3% of GDP deficit reference value and, for euro area and ERM II Member States, in any case not exceed a deficit of 1% of GDP.

As communicated by the authorities, the MTO for Germany is -½% of GDP[17]. In view of the new methodology and given the most recent projections and debt level, the MTO reflects the objectives of the Pact.

The envisaged consolidation is projected to be borne mainly by the Federal government (around 2% of GDP over the period 2011 to 2013) and to a lesser extent by the *Länder* (around ½% of GDP). This results mainly from the consolidation requirements implied by the new constitutional budgetary rule that prescribes a structural deficit ceiling for the Federal government of 0.35% of GDP as of 2016 and balanced structural budgets for the Länder from 2020 onwards. The social security budgets are expected to be broadly balanced over the entire programme horizon, also thanks to the federal government subsidies to statutory health-care insurance (around ¾% of GDP in 2010, incl. a ¼% of GDP one-off additional transfer to compensate for crisis-related revenue shortfalls and around ½% of GDP in 2011).

In structural terms (recalculated in accordance with the commonly agreed methodology), the deficit is projected to improve by around ½% of GDP in 2011, around 1% of GDP in 2012 and around ¾% of GDP in 2013 – to reach around -2¼% of GDP at the end of the programme period. Given rising debt and interest payments increasing towards the programme horizon, the primary balance needs to improve faster than the headline deficit. The fiscal policy is expansionary in 2010 and restrictive from 2011 onwards.

As presented in Table 5, the consolidation envisaged from 2011 onwards is projected to be mainly expenditure-driven, while the revenue ratio would decrease still by around ½% of GDP in 2011 and remain unchanged thereafter at 42% of GDP. This results from a

16 "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council on 10 November 2009, available at: http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm

17 As specified in the programme, the MTO for Germany of ½% of GDP is independent of both possible calculation methods, i.e. it does not depend on the assumption regarding the share of pre-financing of the ageing-related costs until 2040.

technical assumption made in the programme that the necessary restraint effort at the federal level is spread equally across all categories of expenditure (except for interest payments and transfers to other government levels and abroad). According to the programme, after a further increase by around ½ percentage points in 2010, the expenditure-to-GDP ratio would fall in equal annual steps of 1 percentage point towards the programme horizon. The assumed expenditure cuts are mainly due to lower social expenditure, lower aggregated spending on intermediate consumption, social transfer in kind and compensation of employees, lower investment and "other expenditure". Expenditure targets are in line with the national budgetary rule, but the projected consolidation is not supported by any concrete measures. The programme states that specific consolidation measures to meet the requirements of the national budgetary rule and the Council Recommendation under Article 126(7) of 2 December 2009 will be outlined by the Federal government in summer 2010. The consolidation is only partly supported by the termination of the fiscal stimulus measures, e.g. expiry of certain social transfers and levelling-off of the additional public infrastructure investment. Importantly, investment expenditure is projected to fall below its 2009 level.

Table 5: Composition of the budgetary adjustment

(% of GDP)	2008	2009		2010		2011		2012	2013	Change: 2009-2013
	COM	COM	SP	COM	SP	COM[1]	SP	SP	SP	SP
Revenue	**43.7**	**44.6**	**44.4**	**43.3**	**42½**	**42.9**	**42**	**42**	**42**	**-2½**
of which:										
- Taxes on production and imports	12.5	12.7	12.6	12.6	12½	12.6	12½	12½	12½	-½
- Current taxes on income, wealth, etc.	11.3	11.0	10.9	10.1	10	9.9	9½	10	10	-1
- Social contributions	16.4	17.1	17.1	17.0	17	16.8	16½	16½	16½	-½
- Other (residual)	3.7	3.8	3.8	3.6	3½	3.6	3½	3½	3	-½
Expenditure	**43.7**	**48.0**	**47.6**	**48.3**	**48**	**47.5**	**47**	**46**	**45**	**-2½**
of which:										
- Primary expenditure	41.0	45.2	44.9	45.5	n.a.	44.6	n.a.	n.a.	n.a.	-3
of which:										
Compensation of employees and intermediate consumption	11.2	12.1	n.a.	12.0	n.a.	11.9	n.a.	n.a.	n.a.	n.a.
Social payments	24.3	27.0	n.a.	27.2	n.a.	27.0	n.a.	n.a.	n.a.	n.a.
Subsidies	1.1	1.2	1.4	1.3	1½	1.3	1½	1½	1½	0
Gross fixed capital formation	1.5	1.7	1.7	1.9	2	1.6	1½	1½	1½	-½
Other (residual)	2.9	3.2	3.2	2.9	3	2.8	3	3	2½	-½
- Interest expenditure	2.7	2.7	2.7	2.8	2½	2.9	2½	3	3	½
General government balance (GGB)	**0.0**	**-3.4**	**-3.2**	**-5.0**	**-5½**	**-4.6**	**-4½**	**-3½**	**-3**	**½**
Primary balance	**2.7**	**-0.6**	**-0.6**	**-2.2**	**-3**	**-1.7**	**-2**	**-½**	**½**	**1**
One-off and other temporary measures	-0.3	0.0	-0.1	0.0	-0	0.0	-0	-0	-0	0
GGB excl. one-offs	**0.4**	**-3.4**	**-3.1**	**-5.0**	**-5½**	**-4.6**	**-4½**	**-3½**	**-3**	**½**
Output gap[2]	3.0	-2.9	-2.6	-2.6	-2.1	-2.2	-1.3	-1.1	-0.9	1.7
Cyclically-adjusted balance[2]	-1.5	-1.9	-1.9	-3.6	-4.4	-3.5	-4.1	-3.1	-2.3	-0.4
Structural balance[3]	**-1.1**	**-1.9**	**-1.8**	**-3.6**	**-4.4**	**-3.5**	**-3.9**	**-3.0**	**-2.3**	**-0.5**
Change in structural balance		*-0.8*	*-0.7*	*-1.7*	*-2.6*	*0.1*	*0.5*	*0.9*	*0.7*	
Structural primary balance[3]	1.5	0.9	0.9	-0.8	-1.8	-0.6	-1.2	-0.1	0.8	0.0
Change in structural primary balance		*-0.7*	*-0.7*	*-1.7*	*-2.7*	*0.2*	*0.6*	*1.1*	*0.9*	

Notes:

[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.

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

Source :

Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations

4.4. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period until 2011, Table 5 compares the detailed revenue and expenditure projections in the Commission services' autumn 2009 forecast, which are derived under a no-policy change scenario, with those in the updated

programme. However, although the assessment uses the Commission services' forecast as a benchmark, it also takes explicitly into account all available information about more recent developments.

The macroeconomic assumptions appear to be somewhat favourable. As highlighted in the programme, slightly lower real GDP growth of ½ pp. per year in 2010-2013 would already put into question the projected consolidation path and imply that the excessive deficit would not be corrected by 2013.

The consolidation projection included in the programme relies on unspecified measures. Moreover, the programme confirms that the Federal government "will implement the coalition agreement in line with the European Stability and Growth Pact (SGP)", including the tax reform. These tax changes are not included in the medium-term budgetary projection and it remains unclear how the German authorities plan to reconcile them with the consolidation needs.

The projected fiscal retrenchment results from the adjustment steps implied by the national budgetary rule for all levels of the government, but the consolidation paths at the *Länder* level have not been yet defined.

The projections of the revenue ratio are consistent with the more favourable macroeconomic scenario and the tax relief measures already adopted. However, they are heavily burdened by the risk associated with the possible implementation of further tax cuts envisaged in the new government's coalition agreement.

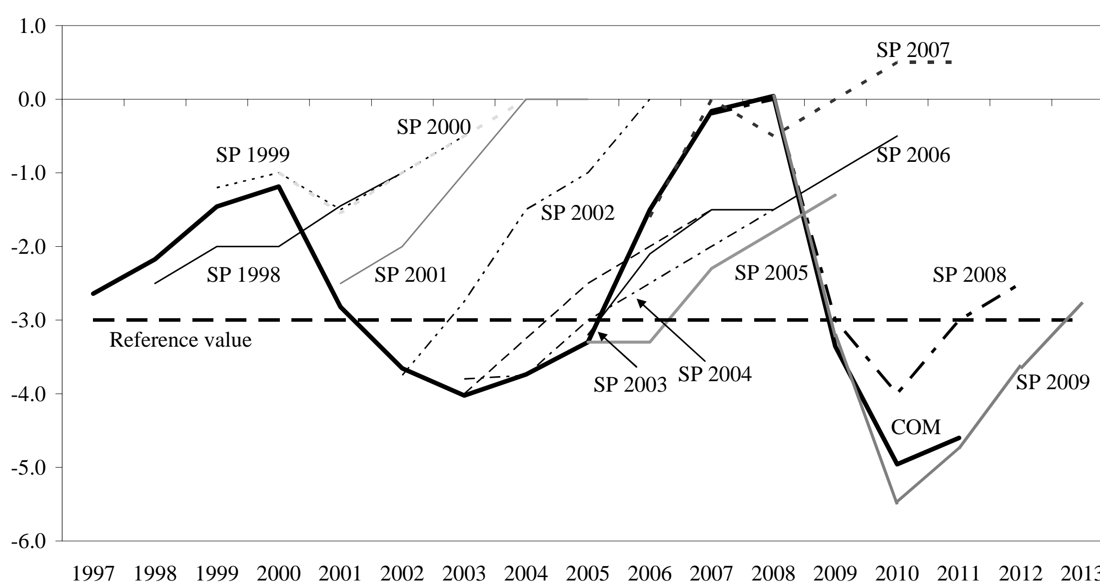
The risk for expenditure projections stems from the lack of information on the specific measures to support the expenditure-driven consolidation as of 2011 and the fact that a more profound retrenchment would be required should the planned tax reform come into force in 2011.

Additional risk concerns financial market stabilisation measures targeted at the banking sector, also in connection with the rescue plan granted to troubled Landesbanken in 2008 which is currently assumed to have direct impact on the debt, but may substantially increase the deficit in the event of assumed risks materialising. Further transactions conducted by the Financial Market Stabilisation Fund (FMSF) would have an immediate impact on the deficit only if the granted guarantees are called upon, recapitalisation is not undertaken at market conditions[18] or the purchase price of assumed risks is higher than the assets' market value. Moreover, Germany has a mixed track record of meeting its budgetary targets. After overtly optimistic budgetary projections submitted until 2004, German authorities have been underestimating budgetary developments in 2004-2006 (see Figure 1). The financial and economic crisis explains to a large extent failure to meet the targets presented in the most recent programmes.

Overall, the budgetary outcomes could turn out worse than projected in the programme, in particular in the year 2011 and beyond. The risks are related to the lack of specific consolidation measures beyond 2010, the need to implement the national budgetary rule also at sub-federal level of the government, the uncertainty about the possible introduction of further tax cuts envisaged in the new government's coalition agreement and their reconciliation with the necessary budgetary retrenchment as well as to somewhat favourable growth assumptions. Additional risks related to financial market stabilisation measures cannot be excluded, although some of the costs of the government support could be recouped in the future.

[18] The capital injection undertaken at the market conditions is accompanied by a similar increase in government assets and would therefore be neutral in terms of net liabilities.

Figure 1: Government balance projections in successive programmes (% of GDP)



Source: Commission services' autumn 2009 forecast (COM) and successive stability programmes

5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

This section includes two parts. The first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. The second part takes a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

5.1. Recent debt developments and medium-term prospects

5.1.1. Debt projections in the programme

As presented in the programme, the debt-to-GDP ratio, having stood at 66% of GDP in 2008, has increased rapidly by 6½ percentage points to 72½% of GDP in 2009 and is to rise by further 4 percentage points in 2010 and reach 82% of GDP in 2013.

The 2009 debt developments were mainly driven by a sharp increase in net borrowing, financial market stabilisation measures – as reflected in the stock-flow adjustment of around 1% of GDP and a decline of the nominal GDP (see Table 6). The 2009 debt-to-GDP ratio turned out broadly in line with the Commission services' estimate but around 4 percentage points higher than projected in the previous programme. This can be mainly attributed to additional recapitalisation and other measures undertaken to stabilise the financial markets and worse-than-expected growth developments.

A further significant increase in the debt ratio in 2010 would be mainly the result of the higher deficit, as reflected in the increased primary balance contribution to debt. The pace of the debt-to-GDP increases from 2010 onwards will be somewhat mitigated by positive growth and inflation effects, despite growing interest expenditure and unspecified debt-increasing stock-flow adjustments of around ½% of GDP p.a. between 2011 and 2013. The debt projection included in the programme relies on the assumption that the level of debt will not be affected by the establishment of "bad banks" out of public banks to collect impaired assets and business divisions not strategically required.

Table 6: Debt dynamics

(% of GDP)	average 2003-07	2008	2009		2010		2011		2012	2013
			COM	SP	COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**66.0**	**65.9**	**73.1**	**72½**	**76.7**	**76½**	**79.7**	**79½**	**81**	**82**
Change in the ratio	0.9	0.9	7.2	6½	3.7	4	2.9	3	1½	1
Contributions[2] *:*										
1. Primary balance	**-0.3**	**-2.7**	**0.6**	**0.6**	**2.2**	**3**	**1.7**	**2**	**½**	**-½**
2. "Snow-ball" effect	**1.2**	**0.9**	**5.6**	**5.1**	**1.5**	**1.2**	**1.2**	**0.5**	**0.6**	**0.8**
Of which:										
Interest expenditure	2.8	2.7	2.7	2.7	2.8	2.6	2.9	2.7	2.9	3.2
Growth effect	-1.0	-0.8	3.5	3.4	-0.8	-1.0	-1.3	-1.4	-1.4	-1.5
Inflation effect	-0.7	-1.0	-0.6	-1.0	-0.5	-0.4	-0.4	-0.9	-0.9	-0.9
3. Stock-flow adjustment	**0.1**	**2.7**	**1.0**	**0.9**	**0.0**	**0.1**	**0.0**	**0.4**	**0.4**	**0.4**
Of which:										
Cash/accruals diff.	-0.1	-0.1		n.a.		n.a.		n.a.	n.a.	n.a.
Acc. financial assets	0.2	2.8		n.a.		n.a.		n.a.	n.a.	n.a.
Privatisation	-0.4	n.a.		n.a.		n.a.		n.a.	n.a.	n.a.
Val. effect & residual	0.0	0.0		n.a.		n.a.		n.a.	n.a.	n.a.

Notes:

[1]End of period.

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

Source :

Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations

5.1.2. Assessment

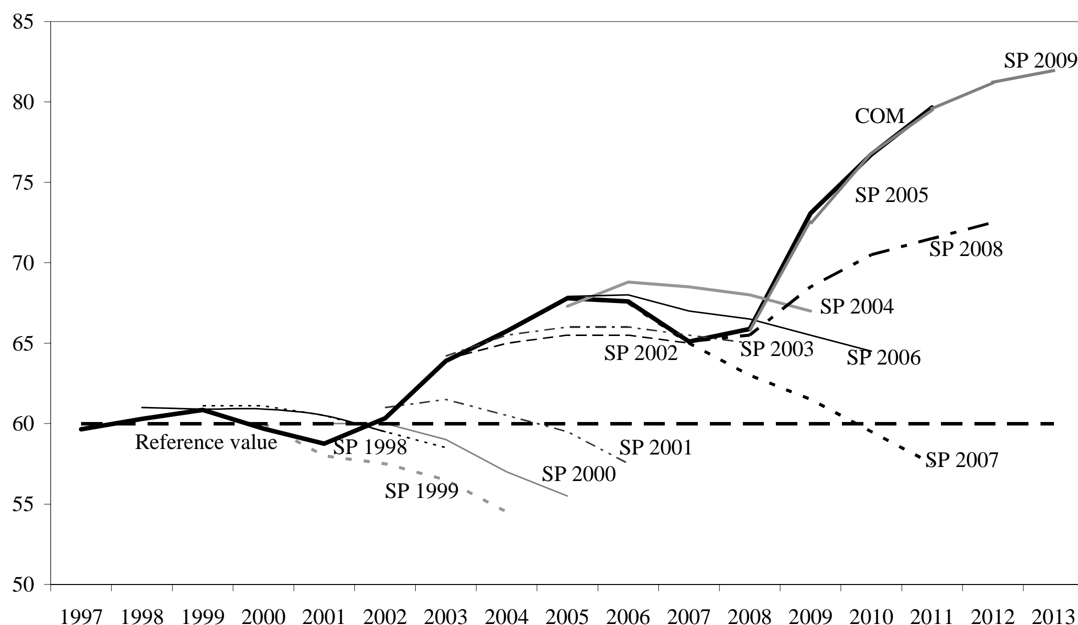
Slight divergences between Commission services' debt projections and those presented in the programme stem mainly from the difference in the primary balance due to the additional stimulus measures in 2010 adopted after the Commission forecast cut-off date, higher nominal GDP growth projections in the programme and indeterminate debt-increasing stock-flow adjustments from 2011 onwards.

As depicted in Figure 2, Germany has a mixed track record in respecting its debt targets, which reflects to great extent its path of meeting deficit targets. The stability programmes submitted before 2004 were systematically undershooting the targets, whereas those stemming from the period 2004-2006 were overestimating the future debt developments. The financial and economic crisis explains the failure to meet the targets of the most recent programmes.

All risks attached to the deficit path referred to above also apply to the debt development. As Germany's debt is mainly issued on a long-term basis (more than one year) and denominated in euro, there are no risks specifically related to debt maturity and currency denomination. However, there is still some risk of further debt increases, should more financial institutes resort to the support of the Financial Market Stabilisation Fund (FMSF) – while the FMSF recapitalisation measures directly affect the debt, the FMSF bank guarantees will only affect the deficit and the debt if and when called. Furthermore, there is some uncertainty regarding the sector classification of debt related to "bad banks" out of public banks.

Taking into account the risks to the debt projections mentioned above, the debt ratio is on an increasing path and above the Treaty reference value over the whole programme period (see Figure 2).

Figure 2: Debt projections in successive programmes (% of GDP)



Source: Commission services' autumn 2009 forecast (COM) and successive stability programmes

5.2. Long-term debt projections and the sustainability of public finances

5.2.1. Long-term debt projections and the sustainability of public finance

This section presents sustainability indicators based on the long-term age-related government spending as projected by the Member States and the EPC in 2009 according to an agreed methodology[19].

Table 7 shows that age-related spending is projected to rise by 5.1 percentage points of GDP between 2010 and 2060, over the EU average (4.6 pps.). Sustainability indicators for two scenarios are presented in Table 8. "The 2009 scenario" is based on a no-policy-change assumption and the 2009 structural primary balance as a starting year, while "the programme scenario" takes into account the consolidation planned in the programme up to 2012 and is based on the projected 2012 structural primary balance as a starting position. Assuming that the structural primary balance remained at its 2009 level and including the increase in age-related expenditure, the sustainability gap (S2)[20] would amount to 4.5% of GDP; around 1¾% of GDP more than in last year's assessment, which is mainly due to a lower estimated structural primary balance in the starting year. Also, the rise in age-related expenditure in the 2009 projection is higher compared to the previous projection. The starting budgetary position is not enough to stabilise the debt ratio over the long-term and compounds the long-term budgetary impact of ageing.

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[19] Economic Policy Committee and the European Commission (2009), '2009 Ageing Report: Economic and budgetary projections for the EU-27 Member States (2008-60)', *European Economy* No. 2/2009. European Commission (2009), 'Sustainability Report 2009, European Economy No. 9/2009. European Commission (2008), 'Public finances in EMU – 2008', *European Economy* No. 4/2008.

[20] The S2 indicator is defined as the change in the current level of the structural primary balance required to make sure that the discounted value of future structural primary balances (including the path of property income) covers the current level of debt.

As the "programme scenario" projects the structural primary balance worsening in 2010 and thereafter returning close to the 2009 level only in the end year (2013) of the programme, the sustainability gap remains by and large at the same level.

5.2.2. Sustainability indicators and long-term debt projections

Table 7: Long-term age-related expenditure: main projections

(% of GDP)	**2007**	**2010**	**2020**	**2030**	**2040**	**2060**	**Change 2010- 60**
Total age-related spending	**23.6**	**23.3**	**23.6**	**25.4**	**26.9**	**28.4**	**5.1**
- Pensions	10.4	10.2	10.5	11.5	12.1	12.8	2.5
- Healthcare	7.4	7.6	8.1	8.5	9.0	9.2	1.6
- Long-term care	0.9	1.0	1.2	1.4	1.8	2.4	1.4
- Education and unemployment benefits	4.8	4.6	3.9	3.9	4.0	4.1	-0.4
Property income received	0.7	0.7	0.7	0.6	0.6	0.5	-0.2

Source: Economic Policy Committee and Commission services.

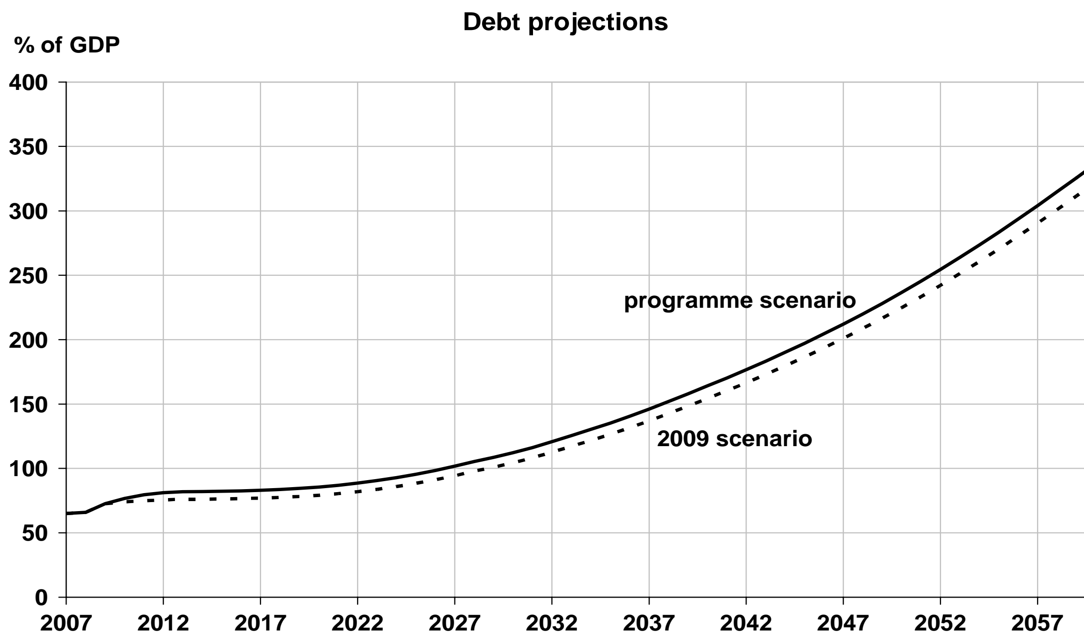
Table 8: Sustainability indicators and the required primary balance

	2009 scenario			**Programme scenario**		
	S1	**S2**	**RPB**	**S1**	**S2**	**RPB**
Value	3.5	4.5	5.1	3.7	4.6	5.2
of which:						
Initial budgetary position (IBP)	0.6	0.7	-	0.8	0.9	-
Debt requirement in 2060 (DR)	0.2	-	-	0.3	-	-
Long-term change in the primary balance (LTC)	2.6	3.7	-	2.6	3.7	-

Source: Commission services.

Based on the assumptions used for the calculation of the sustainability indicators, Figure 3 displays the projected debt/GDP ratio over the long-term.

Figure 3: Long-term projections for the government debt ratio



Note: Being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.
Source: Commission services.

Based on the alternative assumptions of economic developments presented in the commission services' autumn 2009 forecast publication[21], Figure 4 shows projected medium-term trajectory of the debt-to-GDP ratio. The projected debt trajectories show somewhat differing debt paths under the two sets of assumptions. When account is taken on most recent economic developments, the debt level would stabilise at the level of slightly over 80% of GDP in the programme scenario while it would continue to increase according to the 2009 scenario. Under the long-term baseline calculation assumptions, the debt levels would be on an increasing trend in both scenarios.

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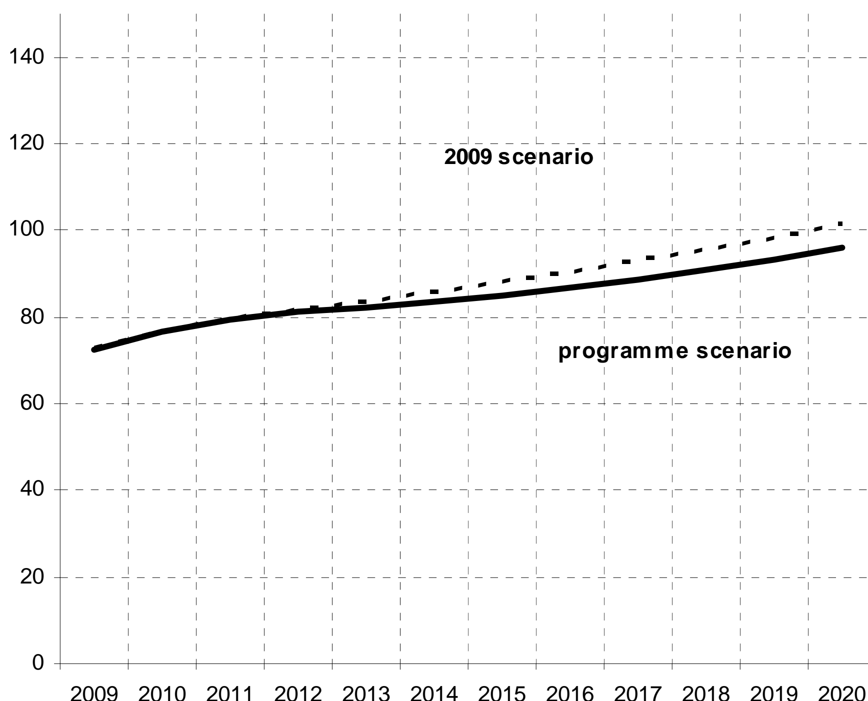
[21] Section 3.5 in European Commission (2009), 'European Economic Forecast – autumn 2009', European Economy No. 10/2009

Figure 4: Medium-term projections for the government debt ratio



Source: Commission services' calculations.

Table 9: Additional factors for the assessment of long-term sustainability risks

	Impact on risk
Debt and pension assets	na
Decline in structural balance until 2011 in COM Autumn 2009 forecast	-
Alternative projection of cost of ageing	na
Strong decline in benefit ratio	na
High tax burden	na
Difference between S1 and S2	na

Note: '-': factor tends to increase the risk to sustainability, '+': factor tends to decrease the risk to sustainability. 'na': not applicable.
Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered "unofficial".
An explanation on these factors can be found in chapter V of: European Commission (2009), Sustainability Report 2009, European Economy No. 9/2009.
Source: Commission services.

5.2.3. Additional factors

For an overall assessment of the sustainability of public finances, other relevant factors are taken into account (Table 9The fact that the structural primary balance is anticipated to return to its 2009 level only in 2013 weighs on the risk of the sustainability of public finances. Overall, the additional factors do not change the assessment of the sustainability risk.

5.2.4. Assessment

The long-term budgetary impact of ageing is slightly above the EU average. The budgetary position in 2009 as estimated in the programme compounds the budgetary impact of population ageing on the sustainability gap. Achieving primary surpluses in the

medium term would contribute to reducing the medium risks to the sustainability of public finances. Medium-term debt projections that assume GDP growth rates to only gradually recover to the values projected before the crisis and tax ratios to return to pre-crisis levels show that the budgetary strategy envisaged in the programme, taken at face value, would not be sufficient to stabilise the debt-to-GDP ratio by 2020.

6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCE

This section is subdivided into two elements: the fiscal framework and the quality of public finances in a broader sense.

6.1. Fiscal framework

The German fiscal framework has been considerably strengthened as a result of the reform of the federal fiscal relations (*Föderalismusreform II*). In August 2009, a new constitutional budgetary rule entered into force[22]. Following the structure of the preventive arm of the SGP, the new rule is a close-to-balance rule that sets the ceiling for federal structural deficit at 0.35% of GDP from 2016 onwards, with a transition period starting in 2011[23]. The regional budgets of the *Länder* must be structurally balanced as of 2020[24], but their respective consolidation paths are unclear. Missing retrenchment plans at the sub-federal level and uncertainties related to future financing needs of the social security funds constitute a potential risk for the consolidation of the general government budget. Nevertheless, the new rule enhances fiscal credibility and reduces considerably the discretionary leeway compared with the former budget rule which could not prevent debt accumulation in the past decades. The rule is accompanied by the introduction of an early warning system designed to prevent budgetary distress. Replacing the Fiscal Planning Council (*Finanzplanungsrat*), the newly created Stability Council (*Stabilitätsrat*), composed of *Bund* and *Länder* finance ministers, will regularly monitor federal and regional budgets, including the implementation of consolidation measures within the framework of the SGP. However, its recommendations are not binding and it is not entitled to impose any sanctions. The fiscal framework is amended by a medium-term budgetary framework for expenditure. To this end, the *Stabilitätsrat* recommends rolling multi-annual expenditure lines for all layers of the government. However, expenditure targets issued by the Fiscal Planning Council were frequently violated in the past given their imprecise definition, opaque monitoring and the lack of a sanctioning

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22 The former budget rule laid down in Article 115 of the German Constitution suffered from several shortcomings (e.g. construction as an investment rule referring to gross, rather then net investment, vague definition of the exemption clause and the lack of sanction mechanism when violating the rule), which opened considerable discretionary leeway. For a detailed discussion see Baumann, E. and Kastrop, C (2008), "A New Budget Rule for Germany", in Fiscal Policy: Current Issues and Challenges, Banca d'Italia, Research Department, Public Finance Workshop 2008; Eppendorfer, C. and Leib, K. (2008), "Germany: revisiting the budget rule", European Commission, ECFIN Country Focus, Vol. 5, Issue 12 and European Commission (2009), "Germany: Macro Fiscal Assessment. An Analysis of the December 2008 Update of the Stability Programme".

23 The ex post enforcement of the rule will be conducted via the adjustment account, where unexpected deviations of actual net borrowing from the permissible maximum level (that limits the net borrowing in the budget plan) are recorded, up to a ceiling of 1.5% of GDP, with the obligation to reduce debit starting at a threshold of 1% of GDP.

24 While at federal level the Financial Plan (2009-2013) already indicates an adjustment path of structural deficit during the transition period, the Länder only committed to reducing structural deficit to bring general deficit down to the 3%-of-GDP reference value by 2013.

device. Their short-term orientation favoured pro-cyclical behaviour which ran against the SGP objective to let the automatic stabilisers operate in a symmetrical way[25].

On the revenue side, budgetary planning of the Federal government relies on tax receipts estimations provided twice a year on the basis of the government macroeconomic projections by an independent advisory working group at the ministry of finance (*Arbeitskreis "Steuerschätzungen"*)[26]. On the expenditure side, the bottom-up approach prevails - the Federal Ministry of Finance is involved in the iterative negotiations of the funding requests accosted by the ministries and agencies. Major shortcoming of this method is the lack of global expenditure control with the ministry of finance.

According to the updated stability programme, the current bottom-up approach to budgetary planning will be changed into a top-down procedure in line with the budgetary "golden rules" laid down in the new government's coalition agreement. The key element of the reform will be the introduction of aggregate spending limits defined at cabinet level and binding for all ministries. Moreover, to strengthen the efficiency of public expenditure, already in October 2006 the government established a project to modernise the system of budgeting and accounting at the federal level. The aim is to have a stronger focus on performance-based budgeting, making public spending subject to a comprehensive cost-effectiveness accounting. The federal ministry of finance announced a pilot phase to end 2013.

6.2. Quality of public finances

The updated stability programme emphasises the importance of both qualitative and quantitative consolidation in order to ensure the long-term sustainability of public finances and enhance potential growth. By restoring the budgetary deterioration in the course of the economic and financial crisis, priority will be given to expenditure-sided consolidation including measures aimed at improving public spending efficiency[27]. To this end, the new government coalition agreement states that all public spending will be subject to a comprehensive revision of their "necessity" and their "contribution to consolidation", while giving particular importance to their growth-enhancing composition. This is conducive to raise the level of productive spending and improve Germany's relatively low ratio of public investment to consumption. On the revenue side, corporate and income tax system remains complex, offering numerous tax concessions.

On the expenditure side, the updated stability programme envisages a further increase of spending on education, education-infrastructure and R&D strengthening thus the base for higher productivity and potential growth. Between 2010 and 2013 the Federal government will raise spending in these areas by 12 bn Euro. In order to ensure that the share of spending on education and research achieves the national target of 10% of GDP, additional efforts are required at the *Länder* level. Despite the plans to increase the spending on R&D and education, the relatively low ratio of investment to public consumption points to the potential for a more growth-oriented composition of expenditure. While the programme recognises the importance of a comprehensive review of public subsidies, it does not outline any concrete plans in this regard. Even though the

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25 See Eppendorfer, C. and Leib, K. (2008).

26 The advisory body groups experts from the federal Ministry of Finance (in charge), federal Ministry of Economics, five biggest research institutes, Federal Statistical Office (Destatis), National Central Bank (Bundesbank), Council of the Economic Experts (Sachverständigenrat), regional finance ministries and the federal association of the communal associations.

27 Empirical evidence suggests that expenditure-sided consolidation enhances the sustainability of public finances more effectively than revenue-sided consolidation with the adverse cyclical effect on growth being less severe. See European Commission (2007), "Public Finances in EMU".

government had already made an important progress in cutting back grants (e.g. homebuyer-allowance), following the *Koch-Steinbrück* Report in 2003, the *Institute of World Economics* calculates the scope for further reductions at 23.5 bn Euro by 2012[28]. Additional efficiency gains could be realised by improving further the budgetary coordination between the federal and the regional governments and through further re-organisation of public administration (e.g. wider use of quality management, outsourcing, e-government, reduction of public sector employment etc.)[29].

In the course of the crisis, the government extended the support of short-time work and stepped up the opportunities to participate in training measures.[30] The government will ease the financial pressure on unemployment insurance and statutory health insurance in 2010 to maintain overall social security contributions below 40% of wages and thus contain the relatively high non-wage labour costs in Germany. The reforms of the pension system since 2001 (e.g. "*Riester*-reform" establishing the multi-pillar system, "*Riester*-factor" etc.) significantly improved the sustainability of the German pension system. The need for fiscal consolidation limits the scope for subsidies to the statutory social security system from the federal budget. Recent *ad hoc* modifications of the pension adjustment formula undermine the credibility of the undertaken pension reforms, as the envisaged correction in later years might prove politically difficult[31]. Regarding statutory health-care insurance, the government established a special committee at the minister level to reconsider the financing of the health-care system, in particular to examine the options for decoupling the health-care insurance contributions from the wage-related income with the view to reduce the non-wage labour costs. First results are expected in July 2010.

On the revenue side, recent reforms of corporate-, income- and inheritance-tax already contributed to the simplification and modernisation of the tax-system. In the context of the fiscal stimulus packages in response to crisis (*Konjunkturpaket I* and *II*), the government extended the basic personal allowance and reduced the initial tax rate of income tax from 15% to 14%. Thus, particularly low-income earner will benefit and incentives are raised for hitherto unemployed to take up work. Further measures in support of the families (higher child allowances and child benefits) were introduced in the "Act to Accelerate Growth" (*Wachstumsbeschleunigungsgesetz*) of 1 January 2010. With respect to the corporate tax system additional incentives for investment were set by higher tax threshold and improved depreciation rules. In addition, the updated programme foresees further change of the income tax system in line with the coalition agreement (e.g. reducing tax burden for low- and middle income earners, establishing a system of staggered tax progression "if possible" as of 1 January 2011) which are subject to the general proviso that they can actually be afforded. However, the updated programme does not envisage any tax concessions' review that could help to identify and remove the distortive exception clauses, which could facilitate the consolidation efforts.

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[28] See *Institut für Weltwirtschaft* (2008), "Subventionsabbau in Deutschland".

[29] See *Bundesrechnungshof* (2009), "Chancen zur Entlastung und Modernisierung des Bundeshaushalts".

[30] The contribution rate to unemployment insurance was reduced repeatedly, bottoming at 2.8% of wages in 2009 and standing now at 3%. For the medium term, the Council of Economic Experts (*Sachverständigenrat*) proposes to embark to a constant, sustainable unemployment premium, which balances the structural budget of the *Bundesagentur* over the cycle and guarantees planning reliability for households and corporations. The *Sachverständigenrat* calculates the sustainable premium at above 4%. See *Sachverständigenrat*, "Annual Report 2007/08" and "Annual Report 2009/10".

[31] See *Sachverständigenrat* (2009), "Annual Report 2009/10 – Securing the future through responsible economic policies" and *OECD* (2010), "2010 Economic Review – Germany (draft)".

7. OVERALL ASSESSMENT

Taking into account risks attached to the budgetary targets discussed above, this section assesses the appropriateness of the fiscal strategy in relation to the Council Recommendations under Article 104(7) of 2 December 2009 with a view to correcting the excessive deficit and the budgetary objectives of the Stability and Growth Pact, against the background of the current economic situation, the debt and long-term sustainability position of the country, and the institutional features of its public finances.

The German 2010 update of the stability programme foresees a widening of the nominal general government deficit from 3.2% of GDP in 2009 to 5½% of GDP in 2010. As it does not rely on any further major measures additional to those that were already known at the time of the country's latest examination under the EDP procedure, it is, taken at face value, in line with the Council EDP recommendation to "implement the fiscal measures in 2010 as envisaged". From 2011 onwards, programme envisages an expenditure-based consolidation that would lead to the correction of the excessive deficit by 2013 – the deadline established by the Council. Taken at face value, all budgetary targets presented in the programme for the period 2011-2013 are in line with the EDP recommendation, but they are not underpinned by any specific measures. Given debt projections presented in the programme, the budgetary strategy is not sufficient to bring the debt-to-GDP ratio back on a downward path, let alone to accelerate the reduction of the gross debt ratio towards the reference value, as recommended by the Council.

The programme envisages an average annual correction of the structural deficit by ½% of GDP in 2010-2013. However, the budgetary outcomes could turn out worse than projected in the programme, in particular in the year 2011 and beyond. The consolidation path from 2011 onwards is not backed up by concrete measures and no information is provided regarding the possible implementation of the expansionary measures proposed in the new government's coalition agreement and their reconciliation with the necessary budgetary retrenchment. The national budgetary rule – a focal point of the consolidation plans – remains to be implemented at all levels of governments. Missing retrenchment plans at the sub-federal level and uncertainties related to future financing needs of the social security funds constitute a potential risk for the consolidation of the general government budget. Moreover, economic recovery proving more sluggish than currently expected could undermine the budgetary objectives. In view of the risks, the average annual fiscal effort may fall short of the adjustment recommended by the Council under Article 126(7). Given debt projections presented in the programme and the risk of possible further financial market stabilisation measures, the budgetary strategy is not sufficient to bring the debt-to-GDP ratio back on a downward path. The envisaged expenditure-driven consolidation as well as planned increases in education and R&D spending would be consistent with the aim of supporting the recovery of potential growth. However, the projected decline in the overall investment ratio below its 2009 level is a source of concern.

Overall, in 2010 the budgetary strategy set out in the programme is consistent with the Council Recommendation under Article 126(7) of 2 December 2009. However, from 2011 on, taking into account the risks, the budgetary strategy may not be consistent with the Council Recommendation under Article 126(7) of 2 December 2009.

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ANNEX. COMPLIANCE WITH THE FORMAT AND CONTENT REQUIREMENTS FOR STABILITY AND CONVERGENCE PROGRAMMES

This annex provides an assessment of whether the programme respects the requirements of Section II of the code of conduct (guidelines on the format and content), notably as far as (i) the model structure (Annex 1 of the code of conduct); (ii) the formal data provisions (Annex 2 of the code of conduct); and (iii) other information requirements is concerned. It also assesses to what extent Country followed up on the Council's recommendation to report on progress made in the correction of the excessive deficit, in a separate chapter of the programme.

(i) Model structure

The update broadly follows the model structure in Annex 1 of the code of conduct.

(ii) Data requirements

Regarding the formal data provisions (Annex 2 of the code of conduct) some compulsory and optional data is missing:

Compulsory data:

- Table 1d (Sectoral balances): data missing are "Statistical discrepancy";
- Table 2 (General government budgetary prospects): missing data are "Property income" (like last year); state and local government are aggregated (like last year); categories "Compensation of employees and intermediate consumption" and "Social payments" are displayed in a different aggregation (like last year), thus no detailed analysis could be made on the projected development of this expenditure components;
- Table 4 (General government debt developments): missing data are "p.m. implicit interest rate on debt" which makes difficult the analysis of long-term sustainability of public finance;
- Table 8 (Basic assumptions) is missing, although some data are mentioned in the text (like last year);
- Table 5 (Cyclical developments) is missing (like last year).

Optional data:

- Table 1b (Price development): missing data on HICP (like last year);
- Table 3 (General expenditure by function) is missing (like last year);
- Table 4 (General government debt developments): detailed data is missing on stock-flow adjustment ("Differences between cash and accruals", "Net accumulation of financial assets", "Privatisation proceeds", "Valuation effects and other") thus the projected debt-increasing stock-flow adjustments in 2011-2013 remain unspecified; data is missing on "Other relevant variables": "Liquid financial assets" and in particular "Net financial debt" which impeded the analysis of the long-term suitability;
- Table 5 (Cyclical developments) is missing and therefore no data is available on "Potential GDP growth", "Output gap", "Cyclical budgetary component", "Cyclically-adjusted balance", "Cyclically-adjusted primary balance" or "Structural balance", thus no comparison could be done between the figures recalculated by the Commission Services on the basis of the information included in the programme and figures calculated by the German authorities;
- Table 7 (Long-term sustainability of public finances): data on pension expenditure is displayed in a different aggregation, missing data on "Total expenditure", "Other age-related expenditures", "Interest expenditure", "Total revenue", "Property income", "Revenue from pension contributions", "Pension reserve fund assets", "Consolidated public pension fund assets", employment groups are defined for age groups 15-64, not 20-64, however additional information is provided for groups 55-64 and 65-71, participation rates are not defined for females and males.

The tables on the following pages show the data presented in the February 2010 update of stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

(iii) Other information requirements

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

The SCP…	Yes	No	Comments
a. Involvement of parliament			
… mentions status vis-à-vis national parliament.	x		
… indicates whether Council opinion on previous programme has been presented to national parliament.	x		
b. Economic outlook			
… (for euro area and ERM II Member States) uses “common external assumptions” on main extra-EU variables.			partly
… explains significant divergences with Commission services' forecasts[1].			n.a.
… bears out possible upside/downside risks to economic outlook.	x		
… analyses outlook for sectoral balances and, especially for countries with high external deficit, external balance.		x	
c. Monetary/exchange rate policy			
… (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.			n.a.
d. Budgetary strategy			
… presents budgetary targets for general government balance in relation to MTO and projected path for debt ratio.	x		
… (in case new government has taken office) shows continuity with respect to budgetary targets endorsed by Council.	x		
… (when applicable) explains reasons for deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify situation (+ provides information on them).		x	
… backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on balance.		x	
… specifies state of implementation of measures.		x	
e. “Major structural reforms”			
… (if MTO not yet reached or temporary deviation is planned from MTO) includes comprehensive information on economic and budgetary effects of possible ‘major structural reforms’ over time.		x	
… includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms.		x	
f. Sensitivity analysis			
… includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of: a) changes in main economic assumptions b) different interest rate assumptions c) (for CP only) different exchange rate assumptions d) if common external assumptions are not used, changes in assumptions for main extra-EU variables.	x		
… (in case of “major structural reforms”) analyses how changes in assumptions would affect budget and potential growth.			n.a.
g. Broad economic policy guidelines			
… provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.			
h. Quality of public finances			
… describes measures to improve quality of public finances, both revenue and expenditure sides.	x		
i. Long-term sustainability			
… outlines strategies to ensure sustainability.	x		

The SCP…	Yes	No	Comments
… includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information).	x		
j. Other information (optional)			
… includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	x		
Notes: SCP = stability/convergence programme; CP = convergence programme [1]To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme. *Source:* *Commission services*			

(iv) Separate chapter on progress made in the correction of the excessive deficit

In its recommendations under Article 104/126(7) of 2 December 2009 with a view to bring the excessive deficit situation to an end, the Council also invited Germany to report on progress made in the implementation of the Council's recommendations in a separate chapter in the updates of the stability programmes. Germany partly complied with this recommendation.

Tables from Annex 2 of the code of conduct

Table 1a. Macroeconomic prospects[1]

	ESA Code	2008	2008	2009	2010	2011[4]	2012[4]	2013[4]
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP	B1*g	*110.26*	1.3	-5.0	1.4	2	2	2
2. Nominal GDP	B1*g	*2495.8*	2.8	-3.7	2.0	3	3	3
Components of real GDP								
3. Private consumption expenditure[2]	P.3	*102.94*	0.4	0.4	-0.5	1	1	1
4. Government consumption expenditure	P.3	*106.99*	2.1	2.7	2.0	½	½	½
5. Gross fixed capital formation	P.51	*105.93*	3.1	-8.6	2.1	4	4	4
6. Changes in inventories and net acquisition of valuables (% of GDP)[3]	P.52 + P.53	*n.a.*	0.4	-0.8	0.1	0	0	0
7. Exports of goods and services	P.6	*168.73*	2.9	-14.7	5.1	3	3	3
8. Imports of goods and services	P.7	*147.12*	4.3	-8.9	3.4	2½	2½	2½
Contributions to real GDP growth								
9. Final domestic demand		-	1.2	-0.9	0.5	1½	1½	1½
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.4	-0.8	0.1	0	0	0
11. External balance of goods and services	B.11	-	-0.3	-3.4	0.8	½	½	½

[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 1b. Price developments[1]

	ESA Code	2008	2008	2009	2010	2011[3]	2012[3]	2013[3]
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		*109.75*	1.5	1.4	0.6	1	1	1
2. Private consumption deflator[2]		*112.79*	2.1	0.1	1.1	1½	1½	1½
3. HICP[4]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
4. Public consumption deflator		*107.74*	1.6	1.7	1.5	1½	1½	1½
5. Investment deflator		*106.86*	1.7	-0.5	-0.4	1	1	1
6. Export price deflator (goods and services)		*101.53*	0.6	-3.0	0.6	2	2	2
7. Import price deflator (goods and services)		*102.15*	1.4	-6.1	1.4	2½	2½	2½

[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.

[4]Optional for stability programmes.

Table 1c. Labour market developments[1]

	ESA Code	2008	2008	2009	2010	2011[4]	2012[4]	2013[4]
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons[5]		*40.279*	1.4	-0.1	-1.0	½	½	½
2. Employment, hours worked[6]		*57.58*	1.3	-2.9	0.3	1	1	1
3. Unemployment rate (%)[7]		*n.a.*	7.2	7.6	8.3	8	8	8
4. Labour productivity, persons[2]		*107.15*	-0.1	-4.9	2.4	1½	1½	1½
5. Labour productivity, hours worked[3]		*110.4*	0.0	-2.2	1.1	1	1	1
6. Compensation of employees	D.1	*1224.01*	3.7	-0.1	-0.2	2½	2½	2½
7. Compensation per employee		*34147*	2.1	0.0	0.9	2	2	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.

[5]Occupied population, domestic concept national accounts definition.

[6]National accounts definition.

[7]Harmonised definition, Eurostat; levels.

Table 1d. Sectoral balances[1]

% of GDP	ESA Code	2008	2009	2010	2011[3]	2012[3]	2013[3]
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	6.6	4.5	4.9	5.0	5½	5½
of which: - Balance on goods and services		6.2	4.1	4.6	4½	5	5
- Balance of primary incomes and transfers		0.4	0.4	0.3	½	½	½
- Capital account		0.0	0.0	0.0	-0	0	0
2. Net lending/borrowing of the private sector[2]	B.9	5.7	6.1	6.2	6	5½	5
3. Net lending/borrowing of general government	EDP B.9	0.0	-3.2	n.a.	n.a.	n.a.	n.a.
4. Statistical discrepancy		n.a.	optional	optional	optional	optional	optional

[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 2. General government budgetary prospects

	ESA Code	2008	2008	2009	2010	2011	2012	2013
		Level	% 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	-5½	-4½	-3½	-3
2. Central government	S.1311	*-14.1*	-0.6	-1.7	-3½	-2½	-2	-1½
3. State government	S.1312	*7.0*	0.3	-1.0	-2	-2	-1½	-1½
4. Local government	S.1313	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
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	42½	42	42	42
7. Total expenditure	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	-5½	-4½	-3½	-3
9. Interest expenditure	EDP D.41	*67.1*	2.7	2.7	2½	2½	3	3
10. Primary balance[2]		*68.1*	2.7	-0.6	-3	-2	-½	½
11. One-off and other temporary measures[3]		-	-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	22½	22	22	22½
12a. Taxes on production and imports	D.2	*311.4*	12.5	12.6	12½	12½	12½	12½
12b. Current taxes on income, wealth, etc	D.5	*281.2*	11.3	10.9	10	9½	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	16½	16½	16½
14. Property income	D.4	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
15. Other [4]		*91.1*	3.7	3.8	3½	3½	3½	3
16=6. Total revenue	TR	*1091.8*	43.7	44.4	42½	42	42	42
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]		-	40.1	40.6	39	38½	39	39
Selected components of expenditure								
17. Compensation of employees + intermediate consumption	D.1+P.2	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
17a. Compensation of employees	D.1	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
17b. Intermediate consumption	P.2	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
18. Social payments (18=18a+18b)		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
18b. Social transfers other than in kind	D.62	*421.6*	16.9	18.5	18½	18	17½	17
19=9. Interest expenditure	EDP D.41	*67.1*	2.7	2.7	2½	2½	3	3
20. Subsidies	D.3	*28.0*	1.1	1.4	1½	1½	1½	1½
21. Gross fixed capital formation	P.51	*37.4*	1.5	1.7	2	1½	1½	1½
22. Other[6]		*72.1*	2.9	3.2	3	3	3	2½
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	19½	19½	19

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

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

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

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

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	2007	2012
1. General public services	1	n.a.	n.a.
2. Defence	2	n.a.	n.a.
3. Public order and safety	3	n.a.	n.a.
4. Economic affairs	4	n.a.	n.a.
5. Environmental protection	5	n.a.	n.a.
6. Housing and community amenities	6	n.a.	n.a.
7. Health	7	n.a.	n.a.
8. Recreation, culture and religion	8	n.a.	n.a.
9. Education	9	n.a.	n.a.
10. Social protection	10	n.a.	n.a.
11. Total expenditure (=item 7=23 in Table 2)	TE[1]	n.a.	n.a.

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	2008	2009	2010	2011	2012	2013
1. Gross debt[1]		65.9	72½	76½	79½	81	82
2. Change in gross debt ratio		2.7	4	5½	5	4	3
Contributions to changes in gross debt							
3. Primary balance[2]		-2.7	0.6	3	2	½	-½
4. Interest expenditure[3]	EDP D.41	2.7	2.7	2½	2½	3	3
5. Stock-flow adjustment		2.7	1	0	½	½	½
of which:							
- Differences between cash and accruals[4]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Net accumulation of financial assets[5]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
of which:		-	-	-	-	-	-
- privatisation proceeds		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Valuation effects and other[6]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
p.m.: Implicit interest rate on debt[7]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other relevant variables							
6. Liquid financial assets[8]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
7. Net financial debt (7=1-6)		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	2008	2009	2010	2011	2012	2013
1. Real GDP growth (%)		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
2. Net lending of general government	EDP B.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
3. Interest expenditure	EDP D.41	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
4. One-off and other temporary measures[1]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
5. Potential GDP growth (%)		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
contributions:							
- labour		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- capital		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- total factor productivity		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
6. Output gap		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
7. Cyclical budgetary component		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
8. Cyclically-adjusted balance (2 - 7)		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
9. Cyclically-adjusted primary balance (8 + 3)		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
10. Structural balance (8 - 4)		-1	-1½	-4½	-4	-3	-2½

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

Table 6. Divergence from previous update

	ESA Code	2008	2009	2010	2011	2012	2013
Real GDP growth (%)							
Previous update		1.3	-2.3	1	1	1	n.a.
Current update		1.3	-5.0	1.4	2	2	2
Difference		0.0	-2½	0	½	½	n.a.
General government net lending (% of GDP)	EDP B.9						
Previous update		0.0	-3	-4	-3	-2½	n.a.
Current update		0.0	-3.2	-5½	-4½	-3½	-3
Difference		0.0	-½	-1½	-2	-1	n.a.
General government gross debt (% of GDP)							
Previous update		65.4	68½	70½	71½	72½	n.a.
Current update		65.9	72½	76½	79½	81	82
Difference		-0.5	-4	-6	-8	-8½	n.a.

Table 7. Long-term sustainability of public finances

% of GDP	2007[1]	2015	2020	2030	2040	2050	2060
Total expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension expenditure[3]	10.4	10.1	10.5	11.5	12.1	12.3	12.8
Social security pension	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Old-age and early pensions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other pensions (disability, survivors)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Occupational pensions (if in general government)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health care[4]	7.4	7.9	8.1	8.5	9.0	9.2	9.2
Long-term care[5]	0.9	1.1	1.2	1.4	1.8	2.2	2.4
Education expenditure[6]	3.9	3.4	3.2	3.3	3.4	3.4	3.5
Other age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Interest expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: property income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which : from pensions contributions (or social contributions if appropriate)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension reserve fund assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which : consolidated public pension fund assets (assets other than government liabilities)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assumptions							
Labour productivity growth	1.5	1.6	1.7	1.7	1.7	1.7	1.7
Real GDP growth	0.9	1.9	1.5	1.3	1.1	1.0	1.0
Participation rate males (aged 20-64)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Participation rates females (aged 20-64)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total participation rates (aged 15-64)[2]	76.2	78.7	79.1	79.3	80.2	79.7	79.8
Unemployment rate	8.4	7.1	6.2	6.2	6.2	6.2	6.2
Population aged 65+ over total population	16.3	17.4	18.6	22.1	24.2	23.6	23.0

[1]Germany uses 2007, 2015, 2020, 2030, 2040, 2050, 2060 instead of 2000, 2005, 2010, 2020, 2030, 2050.

[2]Germany uses 15-64 instead of 20-64.

[3]Statutory pension insurance.

[4]Public health expenditure.

[5]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.

[6]Excluding education expenditure by the Federal Labour Agency.

Table 8. Basic assumptions

	2008	2009	2010	2011	2012	2013
Short-term interest rate[1] (annual average)	3.9	1.2	1.0	1.0	1.0	1.0
Long-term interest rate (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
USD/€exchange rate (annual average) (euro area and ERM II countries)	1.27	1.39	1.48	1.48	1.48	1.48
Nominal effective exchange rate	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
(for countries not in euro area or ERM II) exchange rate vis-à-vis the €(annual average)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
World excluding EU, GDP growth	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
EU GDP growth	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Growth of relevant foreign markets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
World import volumes, excluding EU	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Oil prices (Brent, USD/barrel)	97	62	75	75	75	75

[1]If necessary, purely technical assumptions.