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COMMISSION OPINION

of 22.11.2022

on the Draft Budgetary Plan of Germany

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(Only the German text is authentic)

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area, to ensure that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan by 15 October, presenting the main aspects of the budgetary outlook of the general government and its subsectors for the forthcoming year.

3. The general escape clause of the Stability and Growth Pact has been active since March 2020.[1] On 23 May 2022, the Commission indicated, in its Communication on the European Semester[2], that heightened uncertainty and strong downside risks to the economic outlook in the context of war in Europe, unprecedented energy price hikes and continued supply chain disturbances warrant the extension of the general escape clause of the Stability and Growth Pact through 2023 and it considered that the conditions to deactivate it as of 2024 were met. The continued activation of the general escape clause in 2023 will provide the space for national fiscal policy to react promptly when needed, while ensuring a smooth transition from the broad-based support to the economy during the pandemic times towards an increasing focus on temporary and targeted measures and fiscal prudence required to ensure medium-term sustainability.[3]

4. The Recovery and Resilience Facility, as established by Regulation (EU) 2021/241, provides financial support for the implementation of reforms and investment, notably to promote the green and digital transitions, thereby strengthening the economies' resilience and potential growth. Part of this support is in the form of non-repayable financial support ("grants"), entailing a fiscal impulse financed by the Union. Together with cohesion policy funds and the Just Transition Mechanism, the RRF is supporting a fair and inclusive recovery in the EU in line with the European Pillar of Social Rights. It also boosts growth and job creation in the medium and long term, and thereby strengthens sustainable public finances. According to the Commission

[1] Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, COM(2020) 123 final of 20 March 2020.

[2] COM(2022) 600 final.

[3] On 17 June 2022, the Council agreed its recommendations on the 2022 National Reform Programmes and the opinions on the 2022 Stability and Convergence Programmes, which takes into account the continuation of the Stability and Growth Pact's general escape clause into 2023. (See: https://www.consilium.europa.eu/en/meetings/ecofin/2022/06/17/)

proposal of 18 May 2022[4], the Facility should also aim at increasing the resilience of the Union energy system by reducing dependence on fossil fuels and diversifying energy supplies at Union level ('REPowerEU objectives').

5. On 12 July 2022, in the recommendations delivering Council opinions on the 2022 Stability Programmes[5], the Council recalled that the overall fiscal stance is currently best measured as the change in primary expenditure (net of discretionary revenue measures and excluding temporary emergency measures related to the COVID-19 crisis), including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds, relative to medium-term potential growth.[6] Going beyond the overall fiscal stance, in order to assess whether national fiscal policy is prudent and its composition is consistent with the green and digital transitions, energy security and ensuring social and economic resilience, attention is also paid to the evolution of nationally financed[7] primary current expenditure (net of discretionary revenue measures and excluding temporary emergency measures related to the COVID-19 crisis) and investment.

6. The shocks unleashed by the Russian invasion of Ukraine are impacting the EU economy both directly and indirectly, setting it on a path of lower growth and higher inflation. Intensifying and broadening inflationary pressures have been prompting faster normalisation of monetary policy in the euro area. Public spending on measures containing the social and economic impact of high energy costs, on security and defence and on humanitarian assistance to the displaced persons from Ukraine is weighing on public finances. The specific nature of the macroeconomic shock imparted by Russia's invasion of Ukraine, as well as its long-term implications for the EU's energy security needs, call for a careful design of fiscal policy in 2023. A broad-based fiscal impulse to the economy in 2023 does not appear warranted. The focus should instead be on protecting the vulnerable, allowing automatic stabilisers to operate and providing temporary and targeted measures to mitigate the impact of the energy crisis and to provide humanitarian assistance to people fleeing from Russia's invasion of Ukraine, while maintaining the agility to adjust, if needed. Fiscal policy should combine higher investment with controlling the growth in nationally financed primary current expenditure. Full and timely implementation of the Recovery and Resilience Plans is key to achieving higher levels of investment. Fiscal policies should aim at preserving debt sustainability as well as raising the growth potential in a sustainable manner, thus also facilitating the task of monetary policy to ensure the timely return of inflation to the ECB's 2% medium-term target. Fiscal plans for 2023 should be anchored by prudent medium-term adjustment paths reflecting fiscal sustainability challenges associated with high debt-to GDP levels that have increased further due to the pandemic as well as reforms and investment challenges associated with the twin transition, energy security and social and economic resilience.

7. Russia's war of aggression against Ukraine has resulted in substantial additional increases in and volatility of the prices of energy. The price shock in imported energy

[4] COM(2022) 231 final.

[5] Council Recommendation of 12 July 2022 on the National Reform Programme of Germany and delivering a Council opinion on the 2022 Stability Programme of Germany, OJ C 334, 1.9.2022, p. 35.

[6] The estimates on the fiscal stance and its components in this Opinion are Commission estimates based on the assumptions underlying the Commission 2022 autumn forecast. The Commission's estimates of medium-term potential growth do not include the full positive impact of reforms that are part of the Recovery and Resilience Plan and that can boost potential growth.

[7] Not financed by grants under the Recovery and Resilience Facility or other Union funds.

implies a substantial terms-of-trade loss to Member States' economies. In parallel, the exceptionally high temperatures in summer 2022 pushed up demand for electricity, while, at the same time, energy production from certain technologies has been significantly below historical levels due to technical and weather-dependant circumstances. All Member States have been negatively affected by the current energy crisis, albeit to a different extent, calling for a rapid and coordinated response.

8. Given that budgetary resources are limited and need to be used in the most efficient way, in order to manage a durable and equitable adjustment across society, the quality and design of the policy response is highly important. Therefore, also in line with the Council Regulation on an emergency intervention to address high energy prices adopted on 6 October 2022, measures should focus on providing temporary support, targeted to households and firms most vulnerable to energy price increases, while maintaining the right incentives to reduce energy demand and increase energy efficiency, in line with the European Green Deal.[8] Policies should also help reducing the energy consumption and develop the energy autonomy of the Union.

CONSIDERATIONS CONCERNING GERMANY

9. On 14 October 2022, Germany submitted the Draft Budgetary Plan for 2023. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

10. On 12 July 2022, the Council recommended that Germany[9] takes action to ensure in 2023 that the growth of nationally financed primary current expenditure is in line with an overall neutral policy stance[10], taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Germany should stand ready to adjust current spending to the evolving situation. Germany was also recommended to expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Recovery and Resilience Facility and other Union funds. For the period beyond 2023, Germany should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions.

11. On 23 May 2022, the Commission issued a report under Article 126(3) of the Treaty. That report assessed the budgetary situation of Germany, as its general government deficit in 2021 exceeded the Treaty reference value of 3% of GDP. The report concluded that the deficit criterion was not fulfilled.

12. According to the Commission 2022 autumn forecast, the German economy is expected to grow by 1.6% in 2022 and to decline by 0.6% in 2023, while inflation is forecast at 8.8% in 2022 and 7.5% in 2023.

According to the Draft Budgetary Plan, the German economy is expected to grow by 2.2% in 2022 and by 2.5% in 2023, while inflation (national consumer price index) is projected at 6.1% in 2022 and 2.8% in 2023. The macroeconomic scenario of the

[8] Communication from the Commission, the European Green Deal, COM(2019) 640 final.

[9] Council Recommendation of 12 July 2022 on the National Reform Programme of Germany and delivering a Council opinion on the 2022 Stability Programme of Germany, OJ C 334, 1.9.2022, p. 35.

[10] Based on the Commission autumn 2022 forecast, the medium-term (10-year average) potential output growth of Germany, that is used to measure the fiscal stance, is estimated at 7.7% in nominal terms. The Commission's estimates of medium-term potential growth do not include the full positive impact of reforms that are part of the Recovery and Resilience Plan and that can boost potential growth.

Draft Budgetary Plan is based on a different cut-off date as it was prepared in April 2022 and therefore does not take into account the latest developments and prospects for the evolution of energy prices or the inflow of Ukrainian refugees and their economic impact. It projects higher growth for 2022 and an economic expansion in 2023, in contrast to the Commission 2022 autumn forecast. At the same time, inflation projections in the Draft Budgetary Plan are much lower across all demand components. Combining volume and price effects, nominal GDP and components and the wage bill are projected at lower levels relative to the Commission forecast. The employment level is projected to be lower in 2022, but higher in 2023, compared to the Commission forecast.

Overall, the macroeconomic assumptions underpinning the Draft Budgetary Plan are favourable in 2022 and markedly favourable in 2023 in real terms, but cautious in nominal terms for both 2022 and 2023.

Germany complies with the requirement of Regulation (EU) No 473/2013 since the draft budget is based on independently endorsed macroeconomic forecasts. However, the fiscal planning does not use the most up-to-date information and relies on data half a year old, despite the rapidly changing economic environment.

13. The Draft Budgetary Plan assumes that expenditure amounting to 0.2% of GDP in 2022 and 0.1% in 2023 will be financed by non-repayable financial support (grants) from the Recovery and Resilience Facility. Expenditures financed by Recovery and Resilience Facility grants will enable high-quality investment and productivity-enhancing reforms without a direct impact on the general government deficit and debt of Germany. The Commission 2022 autumn forecast includes a similar amount of expenditures financed by Recovery and Resilience Facility grants.

14. In its 2023 Draft Budgetary Plan, Germany's general government deficit is planned to decrease from 3½% of GDP in 2022 to 2% of GDP in 2023, mainly due to the phasing out of pandemic-related support measures. The general government debt ratio is planned to decrease from 67¾% of GDP in 2022 to 66¾% of GDP in 2023. The Commission 2022 autumn forecast expects a lower deficit of 2.3% of GDP in 2022 and a higher deficit of 3.1% of GDP in 2023, while government debt is projected slightly lower in both years at 67.4% of GDP in 2022 and 66.3% of GDP in 2023.

Differences in the general government balance and debt can be explained by the lower expected tax revenue in the Draft Budgetary Plan which was based on the tax estimations of May 2022 and the macroeconomic forecast of April 2022. The Commission 2022 autumn forecast includes the budgetary expenditure for the gas price brake of around 0.1% of GDP in 2022, 1.6% of GDP in 2023 and 0.8% of GDP in 2024 that is not included in the Draft Budgetary Plan.

The outlook for public finances continues to be subject to the high uncertainty that surrounds the macroeconomic projections, including macroeconomic risks related to the Russian invasion of Ukraine, energy prices and continued supply chain disturbances. The nationalisation of gas suppliers critical for the functioning of the gas market in Germany entails the risk of further budgetary costs depending on the future evolution of the gas price.

15. Measures underpinning the Draft Budgetary Plan have an overall deficit and debt increasing impact of 3.1% of GDP in 2022 and 2.2% of GDP in 2023. Measures on the revenue side reduce government revenues by around 0.7% of GDP in 2022 and

0.9% of GDP in 2023. These measures include pandemic-related compensations to the health sector, which reduce revenues from social contributions by around 0.4% of GDP in 2022, while various income tax measures such as an increase of the basic personal allowance, adaptations of the tax brackets to inflation and the increase of child allowances lead to revenue reductions of 0.6% of GDP in 2023. Measures on the expenditure side increase government spending by around 2.4% of GDP in 2022 and 1.3% of GDP in 2023. Several support measures against heightened energy prices of around 1.0% of GDP and pandemic-related additional expenditure of around 0.8% of GDP increase government spending in 2022. Expenditure measures in 2023 comprise measures against heightened energy prices of around 0.3% of GDP and defence spending of around 0.3% of GDP as well as expenditure by the Energy and Climate Fund on the green transition of around 0.4% of GDP. These measures for defence and the green transition, as well as the above mentioned tax measures have a more permanent character without being matched by offsetting measures.

The government deficit is impacted by the above mentioned measures adopted to counter the economic and social impact of the exceptional increases in energy prices, which aggravated over the course of the summer.[11] The budgetary cost of these measures is projected in the Commission 2022 autumn forecast to amount to 1.1% of GDP in 2022 and 1.8% of GDP in 2023. They consist of measures reducing government revenue, namely the reduction of the VAT rate on gas, as well as the temporary abolition of the energy tax on fuels, and increasing expenditure, such as one-time lump sum payments including an energy bonus as well as the advanced abolishment of the surcharge for renewable energies. The Commission 2022 autumn forecast also includes, on top of the measures of the Draft Budgetary Plan, additional expenditure for a gas price brake of around 0.1% of GDP in 2022 and 1.6% of GDP in 2023. These measures have been announced as temporary, expiring mostly by the end of 2022 or by April 2024 at the latest. Most measures do not appear targeted to vulnerable households or firms[12], and do not fully preserve the price signal to reduce energy demand and increase energy efficiency.[13] As a result, the amount of temporary and targeted support to households and firms most vulnerable to energy price hikes, that can be taken into account in the assessment of compliance with the fiscal country-specific recommendation for 2023, is estimated in the Commission 2022 autumn forecast at 0.3% of GDP in 2022 and 0.1% of GDP in 2023.

The government deficit is also impacted by the costs to offer temporary protection to displaced persons from Ukraine, which in the Commission 2022 autumn forecast are projected at 0.1% of GDP in both 2022 and 2023.

16. Based on the Commission 2022 autumn forecast and including the information incorporated in Germany’s 2023 Draft Budgetary Plan, gross fixed capital formation is expected to amount to 2.7% of GDP in 2022 and 2.8% of GDP in 2023, compared to 2.6% of GDP recorded in 2021. This includes investment, which together with other measures (like investment grants and tax incentives for the green and digital transitions and for energy security, such as energetic renovations of buildings,

[11] Deficit developments in 2023 are also affected by the complete phasing out of COVID-19 emergency temporary measures, which are estimated in the Commission autumn 2022 forecast at 1.4% of GDP in 2022.

[12] Targeted measures amount to 0.3% of GDP in 2022 and 0.1% of GDP in 2023, while untargeted measures amount to 0.8% of GDP in 2022 and 1.7% of GDP in 2023.

[13] Income measures amount to 0.7% of GDP in 2022 and 1.5% of GDP in 2023, while price measures amount to 0.4% of GDP in 2022 and 0.2% of GDP in 2023.

digitisation of schools, improvement of the charging infrastructure for electric cars or the extension of energy networks and wind energy) are partly funded by the Recovery and Resilience Facility and other EU funds.

17. In 2023, the fiscal stance is projected in the Commission 2022 autumn forecast to be expansionary (-0.4% of GDP[14]). This follows an expansionary fiscal stance in 2022 (-2.1% of GDP).

The growth in nationally financed primary current expenditure (net of new revenue measures) in 2023 is projected to provide an expansionary contribution of 0.3 percentage points.[15] This includes the increased impact from the support measures adopted to counter the economic and social impact of the exceptional increases in energy prices by 0.7% of GDP[16], while the temporary and targeted support measures to households and firms most vulnerable to energy price hikes have a reduced impact of 0.2% of GDP. Therefore, the expansionary contribution of nationally financed primary current expenditure is not due to the temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. The expansionary growth in nationally financed primary current expenditure (net of new revenue measures) is driven by changes to the income tax system reducing the tax bracket creep and increasing the tax-free basic allowance, increases in the child allowance, reduction of the value added tax on gas and district heating as well as a reform of the social welfare system.

The positive contribution to economic activity of expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to decrease by 0.1 percentage point of GDP in 2023 compared to 2022. Nationally financed investment is projected to provide a neutral contribution to the fiscal stance in 2023.[17]

18. The Draft Budgetary Plan includes medium-term budgetary projections until 2026. The government deficit is projected to decrease gradually to 2% of GDP in 2024, 1½% in 2025 and to 1% of GDP in 2026. These plans are based on a constant structural annual adjustment of 0.5% of GDP each year from 2023 onwards. In turn, government debt is envisaged to peak at 67¾% of GDP in 2022 and to decline to 65¼% of GDP by 2026. Germany announced at the end of September 2022 a EUR 200 billion support package for fighting the heightened energy prices by introducing, amongst other measures, a gas price brake. These measures, which have not been included in the projections of the Draft Budgetary Plan, entail a risk to the medium-term budgetary planning.

19. On 12 July 2022, the Council also recommended Germany to improve the tax mix for more inclusive and sustainable growth, in particular by improving tax incentives to increase hours worked and to safeguard the long-term sustainability of the pension system. The Draft Budgetary Plan includes some tax measures reducing the overall income tax burden and contributing to a more inclusive and sustainable growth,

[14] A negative (positive) sign of the indicator corresponds to an excess (shortfall) of primary expenditure growth compared with medium-term economic growth, indicating an expansionary (contractionary) fiscal policy. The fiscal stance includes the fiscal impulse funded by the Union.

[15] This follows an expansionary contribution from this component of 1.8 percentage points in 2022.

[16] The budgetary impact of targeted price and income measures is projected to remain stable for both, while the budgetary impact of untargeted price and income measures is projected to increase by 0.3% and decrease by 0.2% of GDP respectively.

[17] Other nationally financed capital expenditure is projected to provide an expansionary contribution of 0.2 percentage points of GDP.

while for the other recommendations some planned measures are expected to be implemented beyond 2023.

20. In 2023, based on the Commission's forecast and including the information incorporated in the Draft Budgetary Plan, the overall fiscal policy stance is estimated to be expansionary in a situation of high inflation. This includes an expansionary contribution to the overall fiscal stance from nationally financed current expenditure. This expansionary contribution is not the result of temporary and targeted support to households and firms most vulnerable to energy price hikes and the cost to assist people fleeing Ukraine. Overall, the growth of nationally financed primary current expenditure is not in line with the recommendation of the Council. Germany plans to finance additional investment through the RRF and other EU funds and it also preserves nationally financed investment. It plans to finance investment grants and various other measures including tax incentives for the green and digital transitions, and for energy security.

Overall, the Commission is of the opinion that the Draft Budgetary Plan for Germany is partly in line with the fiscal guidance contained in the Council recommendation of 12 July 2022. The Commission invites Germany to take the necessary measures within the national budgetary process to ensure that the 2023 budget is consistent with the recommendation adopted by the Council on 12 July 2022.

While Germany rapidly deployed energy measures as part of the emergency policy response to the exceptional energy price hikes, a prolongation of existing and/or an enactment of new support measures in response to high energy prices would contribute to higher growth in net nationally financed current expenditure and to an increase in the projected government deficit and debt in 2023. Therefore, it is important that Member States better focus such measures to the most vulnerable households and exposed firms, to preserve incentives to reduce energy demand, and to be withdrawn as energy price pressures diminish.

The Commission is also of the opinion that Germany has made limited progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 12 July 2022 in the context of the European Semester and thus invites the authorities to accelerate progress. A comprehensive description of progress made with the implementation of the country-specific recommendations will be made in the 2023 Country Report and assessed in the context of the country-specific recommendations to be proposed by the Commission in spring 2023.

Done at Brussels, 22.11.2022

For the Commission
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