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COMMISSION OPINION

of 19.5.2022

on the updated Draft Budgetary Plan of Germany

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013[1] 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 of 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 situation of the general government and its subsectors for the forthcoming year.

3. The General Escape Clause has been active since March 2020.[2] On 2 June 2021, on the basis of the Commission's 2021 spring forecast, the Commission considered that the conditions to continue to apply the general escape clause in 2022 were met.[3]

4. Next Generation EU, including the Recovery and Resilience Facility, supports a sustainable, inclusive and fair recovery. Regulation (EU) 2021/241 established the Recovery and Resilience Facility[4] which provides financing support for the implementation of reforms and investments, 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 EU budget. By contributing to economic recovery and to strengthening long-term growth, it supports public finances, growth and job creation in the medium and long term.

5. On 2 June 2021, the Commission emphasised in its communication that the coordination of national fiscal policies remains crucial to underpin the recovery. In this context, the Commission set out its view that the overall fiscal stance, taking into account national budgets and the Recovery and Resilience Facility, should remain supportive in 2021 and 2022. Fiscal policy should remain agile and adjust to the evolving situation as warranted, and a premature withdrawal of fiscal support should be avoided. Once health risks diminish, fiscal measures should gradually pivot to more targeted measures that promote a resilient and sustainable recovery. Finally, with economic activity gradually normalising in 2021, Member States' fiscal policies should become more differentiated in 2022, taking into account the state of the recovery, fiscal sustainability and the need to reduce economic, social and territorial

[1] Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (OJ L 140, 27.5.2013, p. 11).

[2] Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, Brussels, 20.3.2020, COM(2020) 123 final.

[3] Communication from the Commission on economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy, Brussels, 2.6.2021, COM(2021) 500 final.

[4] Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and resilience Facility (OJ L57, 18.2.2021, p.17).

divergences. All Member States should preserve nationally financed investment. As the recovery takes hold, fiscal policy should prioritise higher public and private investment, supporting the transition towards a green and digital economy.

In its recommendations on the 2021 Stability Programmes on 18 June 2021, the Council also recommended that, when economic conditions allow, Member States should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring fiscal sustainability in the medium term. At the same time, investment should be enhanced to boost growth potential.

The Council, on 13 July 2021, further recommended to euro area Member States[5] to take action, individually and collectively within the Eurogroup, in the period 2021–2022 to ensure a policy stance that supports the recovery from the COVID-19 crisis. When the epidemiological and economic conditions allow, emergency measures should be phased out while combatting the social and labour-market impact of the crisis. Recalling the need for prudent medium-term fiscal positions and debt sustainability, while enhancing investment, the Council also called for particular attention to the quality of budgetary measures.

On 2 March 2022, the Commission in its Communication[6] noted that fiscal policies needed to stand ready to react to the rapidly changing circumstances in light of the evolving policy environment and that the continued application of the general escape clause in 2022 would allow fiscal policy to adjust to address the immediate challenges posed by this crisis.

6. On 18 June 2021, in its recommendations on the 2021 Stability Programmes, the Council highlighted that the established indicators of fiscal adjustment set out in Regulation (EC) No 1466/97[7] need to be considered in the context of the current circumstances. Specifically, the assessment of the overall fiscal stance at the current juncture should take into account the transfers from the EU budget (such as those from the Recovery and Resilience Facility). Furthermore, the assessment also needs to take into account the phasing-out of COVID-19 crisis-related temporary emergency measures that were designed to support health systems and compensate workers and firms for the losses in income due to lockdowns and supply chain disruptions, while their withdrawal is accompanied by the easing of lockdown restrictions that will support growth.

Accordingly, the fiscal stance in 2021 and 2022 is measured by the change in primary expenditure (net of discretionary revenue measures), excluding COVID-19 crisis-related temporary emergency measures but including expenditure financed by grants under the Recovery and Resilience Facility and other EU funds, relative to medium-term potential growth.[8] Going beyond the overall fiscal stance, in order to assess whether national fiscal policy is prudent and its composition is conducive to a sustainable recovery consistent with the green and digital transitions, attention is also paid to the evolution of nationally financed primary current expenditure (net of

[5] Council Recommendation of 13 July 2021 on the economic policy of the euro area, OJ C 283, 15.7.2021, p. 1.

[6] Communication from the Commission to the Council: Fiscal policy guidance for 2023, Brussels, 2.3.2022, COM(2022) 85 final.

[7] Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies (OJ L 209, 2.8.1997, p. 1), as amended.

[8] The Commission's estimates of medium-term potential growth do not include the positive impact of reforms that are part of the Recovery and Resilience Plan and can boost Germany's potential growth.

discretionary revenue measures and excluding COVID-19 crisis-related temporary emergency measures) and investment.

CONSIDERATIONS CONCERNING GERMANY

7. On 15 October 2021, Germany submitted a Draft Budgetary Plan. On 24 November 2021, the Commission issued an opinion on this Plan.[9] Following a general election on 26 September 2021, the new government took office on 8 December 2021.

8. On 27 April 2022, Germany submitted an updated Draft Budgetary Plan for 2022. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

9. On 18 June 2021, the Council recommended that in 2022 Germany[10] maintains a supportive fiscal stance, including from the impulse provided by the Recovery and Resilience Facility, and preserves nationally financed investment.

The Council also recommended to pay particular attention to the composition of public finances, on both the revenue and expenditure side of the national budget, and to the quality of budgetary measures in order to ensure a sustainable and inclusive recovery; to prioritise sustainable and growth-enhancing investment, in particular investment supporting the green and digital transition; and to give priority to fiscal structural reforms that will help provide financing for public policy priorities and contribute to the long-term sustainability of public finances, including, where relevant, by strengthening the coverage, adequacy and sustainability of health and social protection systems for all.

10. According to the Commission 2022 spring forecast, the German economy grew by 2.9% in 2021 and is expected to grow by 1.6% in 2022, while inflation was at 3.2% in 2021 and is forecast at 6.5% in 2022.

The updated Draft Budgetary Plan's macroeconomic scenario forecasts growth at 3.6% and consumer price inflation at 3.3% (according to the national definition) in 2022. The projections for all demand components are higher than the Commission spring 2022 forecast. This difference is mainly due to different cut-off dates of the projections, which in the case of the Draft Budgetary Plan was before the start of Russia's war of aggression against Ukraine when the growth outlook for 2022 was still more optimistic. Therefore, the projections do not take into account recent geopolitical developments, the renewed trade disruptions and the further increase in inflation. Overall, the macroeconomic assumptions underpinning the updated Draft Budgetary Plan are favourable in 2022.

Germany complies with the requirement of Regulation (EU) No 473/2013 since the draft budget is based on independently endorsed macroeconomic forecasts.

11. Germany submitted its Recovery and Resilence Plan on 28 April 2021. The Council approved the assessment of Germany's Recovery and Resilence Plan and adopted the respective Council Implementing Decision on 13 July 2021. A pre-financing payment of Recovery and Resilience Facility grants of 0.1% of GDP was made to Germany in August 2021. The updated Draft Budgetary Plan assumes that

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9 Commission Opinion of 24.11.2021 on the Draft Budgetary Plan of Germany, Brussels, 24.11.2021, C(2021) 9518 final.

10 Council Recommendation of 18 June 2021 delivering a Council opinion on the 2021 Stability Programme of Germany, OJ C 304, 29.7.2021, p. 18.

expenditure amounting to 0.2% of GDP in 2021, 0.2% in 2022, 0.1% in 2023, and 0.1% in 2024 will be funded 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 adding to the general government deficit and debt. The Commission 2022 spring forecast includes a similar amount of expenditures financed by Recovery and Resilience Facility grants in its budgetary projections. Simulations by the Commission services show that the RRP, together with the rest of measures of the European Union Recovery Instrument, has the potential to increase the GDP of Germany between 0.4% and 0.7% by 2026, not including the possible positive impact of structural reforms, which can be substantial.

12. Germany's general government deficit was 3.7% of GDP in 2021. In its 2022 updated Draft Budgetary Plan, it is planned to remain at 3¾% of GDP in 2022, mainly due to the phasing out of pandemic-related support measures being replaced by additional investment in defence and green transition and measures in reaction to heightened energy prices. The general government debt ratio is planned to decrease from 69.3% of GDP at end-2021 to 66¾% of GDP at end-2022. These projections are in line with the Commission 2022 spring forecast for the debt ratio, whereas the Commission expects a lower deficit of 2.5% of GDP, mainly due to slightly lower tax revenue projections based on cautious calculations in November 2021 and more optimistic expectations for implementing subsidies and public investment in the Draft Budgetary Plan.

The outlook for public finances continues to be subject to the high uncertainty that surrounds the macroeconomic projections, including downside risks related to Russia's invasion of Ukraine, gas supply bottlenecks and further constraints on the supply chain. In response to the COVID-19 pandemic, Germany provided significant liquidity support to companies and households, such as guarantees and tax deferrals. This support does not have a direct or immediate budgetary impact but guarantees represent contingent liabilities for the general government sector. The Commission estimates that the guarantees taken up amounted to around 1.6% of GDP on 31 December 2021.

13. Measures underpinning the updated Draft Budgetary Plan have an overall deficit and debt increasing impact of 2.3% of GDP in 2022. On the revenue side, various measures to increase tax allowances such as the income tax allowance for employees, the basic personal allowance or the allowance for working from home and for long-distance commuters as well as extension of depreciation possibilities lead to a reduction of overall revenues by around 0.4% of GDP and have a longer lasting effect for the next 4 years. Measures on the expenditure side increase government spending by around 1.9% of GDP in 2022. Additional investment in defence as well as increased expenditure by the Energy and Climate Fund in the green transition of around 0.4% of GDP each will increase government spending in the coming years. Additional pandemic-related support measures of around 0.4% of GDP as well as various support measures in reaction to heightened energy prices of 0.7% of GDP are expected to be of a temporary nature and to be phased out by the end of 2022.

Based on the Commission's forecast, the COVID-19 crisis-related temporary emergency measures will decrease from 2.7% of GDP in 2020 and 4.2% in 2021 to 1.2% in 2022.

According to the updated Draft Budgetary Plan, gross fixed capital formation is expected to reach 3% of GDP in 2022, benefitting from the additional investment in defence and in the green transition by the Energy and Climate Fund, which is planned to last for the next 5 years. These projections are in line with the Commission 2022 spring forecast.

Some of these measures, such as the increased spending by the Energy and Climate Fund are aimed at supporting the green and digital transition, as recommended by the Council on 18 June 2021. A complete assessment of the fiscal-structural reforms implemented by Germany will be presented as part of the assessment of the implementation of the Recovery and Resilience Plans and in the 2022 Country Report.

14. The Commission 2022 spring forecast projects an expansionary fiscal stance of -1.6% of GDP in 2022.[11] Germany is projected to use the Recovery and Resilience Facility in 2022 to finance additional investment in support of the recovery. The positive contribution to economic activity of expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to remain stable in 2022 compared to 2021. Nationally financed investment is projected to provide an expansionary contribution to the fiscal stance of 0.2 percentage points in 2022.[12] At the same time, the growth in nationally financed primary current expenditure (net of new revenue measures) in 2022 is projected to provide an expansionary contribution of 1.5 percentage points to the overall fiscal stance. This significant expansionary contribution includes besides existing measures the additional impact of the measures to address the economic and social impact of the increase in energy prices (0.7% of GDP) as well as the costs of providing support to displaced persons following Russia's invasion of Ukraine (0.1% of GDP), while additional spending for the green transition (0.2% of GDP) is also projected to contribute to the growth in net current expenditure.

15. The updated Draft Budgetary Plan includes medium-term budgetary projections until 2026. The government deficit is planned to decrease gradually to 2% of GDP in 2023, 1¾% in 2024, 1% in 2025 and to ½% of GDP in 2026. These plans assume a constant improvement of the primary balance. In turn, government debt is envisaged to fall to 66¾% of GDP in 2022 after the peak at 69.3% in 2021 and to decline to 64½% of GDP by 2026.

16. In 2022, based on the Commission's forecast and including the information incorporated in its updated Draft Budgetary Plan, the fiscal stance, including the impulse provided by the Recovery and Resilience Facility, is projected to be supportive, as recommended by the Council. Germany plans to provide continued support to the recovery by making use of the Recovery and Resilience Facility to finance additional investment. As recommended by the Council, Germany also plans to preserve nationally financed investment.

The Commission recalls the importance of the composition of public finances and the quality of budgetary measures, including through growth-enhancing investment, notably supporting the green and digital transition. These objectives are fulfilled by the measures underpinning the updated Draft Budgetary Plan.

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[11] A negative sign of the indicator corresponds to an excess of primary expenditure growth compared with medium-term economic growth, indicating an expansionary fiscal policy.

[12] Other nationally financed capital expenditure is projected to provide a contractionary contribution of 0.1 percentage points of GDP.

Germany is invited to regularly review the use, effectiveness and adequacy of the support measures, including those aimed at addressing the increase in energy prices, and stand ready to adapt them to changing circumstances.

Done at Brussels, 19.5.2022

For the Commission
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