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COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plan of Germany

Accompanying the document

COMMISSION OPINION

on the draft budgetary plan of Germany

{C(2017) 8013 final}

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1. INTRODUCTION

Germany submitted its Draft Budgetary Plan (DBP) for 2018 on 16 October 2017 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. Given the caretaker nature of the government in place on 16 October 2017, the budgetary projections for 2017 and 2018 in the DBP are based on unchanged policies and include only measures that have been adopted before the national elections of 24 September 2017. Germany is subject to the preventive arm of the Pact and should preserve a sound fiscal position which ensures compliance with the medium term budgetary objective (MTO). As the debt ratio was 68.1% of GDP in 2016 Germany also needs to comply with the debt reduction benchmark.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2017 autumn forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission 2017 autumn forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2017-2018 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis on the composition of public finances and on fiscal-structural issues in response to the latest country-specific recommendations adopted by the Council in the spring of 2017, including reducing the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underlying the DBP assumes that the German economy is experiencing a steady, broad-based upswing driven by domestic demand. In view of the high capacity utilisation and low interest rates, investment is to pick up markedly. Rising employment and strengthening wage growth are expected to boost consumption growth, while consumer inflation moderates again after a pick-up in 2017. Global activity and trade are expected to stay dynamic, supporting export growth and stimulating investment. Due to strong domestic demand, imports are expected to rise faster than exports, resulting in net trade not contributing to growth.

The growth outlook has been revised up compared to the one underlying the 2017 Stability Programme, in view of the better than expected outturn for the first half of 2017, more favourable external assumptions and a pronounced improvement in business and consumer sentiment since spring.

The projections underlying the DBP are somewhat more conservative than the Commission 2017 autumn forecast with respect to domestic demand, in particular private consumption, and overall GDP growth.

Box 1: The macro economic forecast underpinning the budget in Germany

The Commission Opinions on Germany's DBPs have been pointing out that no independent body in charge of producing or endorsing macroeconomic forecasts has been put in place within the meaning of Regulation (EU) No 473/2013. This holds for the macroeconomic scenarios underlying both the DBP and the Stability Programme. The federal budget and fiscal projections at the level of general government are based on the federal government's own macroeconomic forecast, even though its preparation involves the Joint Economic Forecast *(Gemeinschaftsdiagnose)*.

The Joint Economic Forecast is issued twice a year by leading research institutes, shortly before the government's spring and autumn projections, within the framework of research mandates awarded by the government through a call for tenders. Moreover, the Stability Programme is based on the government's January forecast published within the federal government's Annual Economic Report, which is usually prepared without using an updated Joint Economic Forecast as a benchmark.

Table 1. Comparison of macroeconomic developments and forecasts

	2016	2017			2018		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1.9	1.4	2.0	2.2	1.6	1.9	2.1
Private consumption (% change)	2.1	1.4	1.8	2.1	1.4	1.6	1.9
Gross fixed capital formation (% change)	3.1	1.7	3.5	3.8	2.8	3.6	3.6
Exports of goods and services (% change)	2.6	2.8	3.5	3.6	3.6	4.0	4.0
Imports of goods and services (% change)	3.9	3.8	4.4	4.6	4.3	4.7	5.0
Contributions to real GDP growth:							
- Final domestic demand	2.4	1.5	2.0	2.2	1.6	1.9	2.2
- Change in inventories	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	-0.3	-0.1	0.0	-0.1	0.0	0.0	-0.1
Output gap[1]	-0.2	-0.2	0.0	0.0	-0.1	0.1	0.2
Employment (% change)	1.3	0.7	1.5	1.4	0.7	1.1	1.1
Unemployment rate (%)	4.1	3.8	3.5	3.7	3.8	3.2	3.5
Labour productivity (% change)	0.6	0.6	0.4	0.7	0.9	0.8	1.0
HICP inflation (%)	0.4			1.7			1.5
GDP deflator (% change)	1.3	1.4	1.5	1.5	1.6	1.7	1.9
Comp. of employees (per head, % change)	2.2	2.4	2.5	2.4	2.5	2.7	2.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	8.5	8.1	7.5	7.9	7.9	7.4	7.5

Note:
[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:
Stability Programme 2017 (SP); Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The no-policy-change DBP projects a headline general government budget surplus of ¾% of GDP for 2017 and ½% of GDP in 2018. This is slightly above the projection from the Stability Programme, respectively ½% and ¼% of GDP.[1] The difference is mainly due to lower-than-expected expenditure. Total revenue broadly remained stable, while total expenditure in the DBP is planned to be lower by ½% of GDP, notably due to lower-than-expected social payments. In contrast to the Stability Programme, which projected a decrease

[1] The Stability Programme (SP) and the Draft Budgetary Plan (DBP) report revenue and expenditure targets rounded to ¼ percentage point of GDP.

of the structural balance[2] from 0.9% of GDP in 2016 to 0.5% in 2017 and 0.2% in 2018, the no-policy-change DBP forecasts an increase of the (recalculated) structural balance to 1.0% of GDP in 2017 before decreasing to 0.5% in 2018.

The DBP's projections for 2017 are broadly in line with the Commission 2017 autumn forecast, which expects headline and structural surpluses of 0.9% of GDP, respectively. Similarly, the DBP projections for 2018 are also close to the Commission forecast with a headline surplus of 1.0% and a structural surplus of 0.9% of GDP based on a no-policy-change assumption.

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Germany currently standing at 0.35[3]. As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the Draft Budgetary Plan, interest expenditure in Germany is expected to fall from 1.3% of GDP in 2016 to 1¼% in 2017 and to 1% of GDP in 2018. The picture stemming from Germany's plans is broadly in line with the Commission forecast.

Against the background of falling interest expenditure, the projected improvement and then deterioration in the structural balance in 2017-18 (+0.1% and -0.5%, respectively) is accompanied by a more pronounced deterioration in the structural primary balance (0.0% and -0.6%, respectively).

[2] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

[3] 10-year bond yields as of 6 November 2017. Source: Bloomberg.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2016	2017			2018			Change: 2016-2018
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**45.0**	**45 ¼**	**45**	**45.1**	**45 ¼**	**45**	**45.0**	**0**
of which:								
- Taxes on production and imports	10.6	10 ¾	10½	10.7	10 ¾	10½	10.6	0
- Current taxes on income, wealth, etc.	12.6	12 ¾	12¾	12.8	12 ¾	13	12.9	¼
- Capital taxes	0.2	0	0	0.2	0	0	0.2	-¼
- Social contributions	16.7	17	16¾	16.8	17	16¾	16.8	0
- Other (residual)	4.8	4 ¾	4¾	4.6	4 ¾	4½	4.5	-¼
Expenditure	**44.2**	**44 ¾**	**44¼**	**44.2**	**45**	**44¼**	**44.0**	**0**
of which:								
- Primary expenditure	42.8	43 ½	43	43.0	43 ¾	43¼	42.8	¼
of which:								
Compensation of employees	7.5	7 ½	7½	7.5	7 ½	7½	7.4	0
Intermediate consumption	4.8	5	4¾	4.8	5	4¾	4.8	0
Social payments	24.0	24 ½	24¼	24.1	24 ½	24¼	23.9	¼
Subsidies	0.9	¾	¾	0.9	¾	1	0.9	0
Gross fixed capital formation	2.1	2 ¼	2¼	2.2	2 ¼	2¼	2.2	0
Other (residual)	3.5	3 ½	3½	3.6	3 ¾	3¾	3.5	¼
- Interest expenditure	1.3	1 ¼	1¼	1.2	1 ¼	1	1.1	-¼
General government balance (GGB)	**0.8**	½	¾	**0.9**	¼	½	**1.0**	**-¼**
Primary balance	**2.1**	**1 ¾**	**2**	**2.1**	**1 ¼**	**1¾**	**2.2**	**-½**
One-off and other temporary measures	0.0	0	-¼	0.0	0	0	0.0	0
GGB excl. one-offs	**0.8**	½	**1**	**0.9**	¼	½	**1.0**	**-¼**
Output gap[1]	-0.2	-0.2	0.0	0.0	-0.1	0.1	0.2	0.1
Cyclically-adjusted balance[1]	0.9	0.5	0.8	0.9	0.2	0.5	0.9	-0.3
Structural balance (SB)[2]	**0.9**	**0.5**	**1.0**	**0.9**	**0.2**	**0.5**	**0.9**	**-0.3**
Structural primary balance[2]	2.2	1.8	2.2	2.1	1.4	1.6	2.1	-0.6

Notes*:*

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/programme as recalculated by Commission on the basis of the DBP/programme scenario using the commonly agreed methodology.

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

Source:

Stability Programme 2017 (SP); Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations

3.2. Debt developments

The debt-to-GDP ratio decreased by 2.8% of GDP to 68.1% in 2016. The DBP projects the debt-to-GDP ratio to decline further to 65¼% of GDP in 2017 and 63¼% in 2018, owing to the budget surplus and the positive denominator effect of nominal GDP growth. These projections expect a slightly lower debt ratio than the Stability Programme. At the same time, they are largely in line with the Commission 2017 autumn forecast for 2017 and 2018, which shows an even stronger decline of the debt ratio based on the no-policy-change assumption.

Table 3. Debt developments

(% of GDP)	2016	2017			2018		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**68.1**	**66 ¼**	**65¼**	**64.8**	**64**	**63¼**	**61.2**
Change in the ratio	-2.8	-2	-2¾	-3.3	-2 ¼	-2	-3.5
Contributions[2] :							
1. Primary balance	**-2.1**	**-1 ¾**	**-2**	**-2.1**	**-1 ¼**	**-1¾**	**-2.2**
2. "Snow-ball" effect	**-0.9**	**-½**	**-1**	**-1.2**	**-¾**	**-1¼**	**-1.3**
Of which:							
Interest expenditure	1.3	1 ¼	1¼	1.2	1 ¼	1	1.1
Growth effect	-1.3	-1	-1¼	-1.4	-1	-1¼	-1.3
Inflation effect	-0.9	-1	-1	-1.0	-1	-1	-1.2
3. Stock-flow adjustment	**0.3**	¼	¼	**0.0**	**0**	¾	**0.0**
Of which:							
Cash/accruals difference							
Net accumulation of							
of which privatisation proceeds							
Valuation effect & residual							

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 2017 (SP); Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the draft budgetary plan

The no-policy-change DBP only includes discretionary measures on the expenditure side that are still to be reassessed by the incoming government. These measures include increased funding for humanitarian assistance measures abroad and support for peace-keeping/crisis prevention measures, increased funding in internal and external security as well as for investment in the digital infrastructure. For 2017 no budgetary impact is planned and in 2018 all the mentioned measures together have a minor impact below ¼% of GDP. Because of the still uncertain nature and the relatively minor impact of these measures, they have not been considered in the Commission autumn forecast.

The country-specific recommendations issued by the Council on 11 July 2017 call on Germany to use fiscal and structural policies to support potential growth and domestic demand by strengthening public investment. The Draft Budgetary Plan shows increasing investment expenditure in 2017 and 2018 for transport infrastructure together with improvements in planning capacities as well as additional funds for education and modernizing school buildings, including digital equipment. These measures are expected to be growth enhancing and go in the right direction to improve the overall situation of public investment. However, further efforts are needed to clear the investment backlog, especially at municipal level. With the planned stable development of revenues and expenditures, the positive balance of public finances would allow for financing these measures.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2017	**2018**	**2019**
Taxes on production and imports			
Current taxes on income, wealth, etc.			
Capital taxes			
Social contributions			
Property Income			
Other			
Total			

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2018

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2017	**2018**	**2019**
Compensation of employees	0	0	0
Intermediate consumption	0	0	0
Social payments			
Interest Expenditure			
Subsidies	0	0	0
Gross fixed capital formation			
Capital transfers			
Other	0	0	0
Total	0	0	0

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2018

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Germany is subject to the preventive arm of the Stability and Growth Pact and the debt reduction benchmark. Box 2 reports the latest country-specific recommendations in the area of public finances.

Box 2. Council Recommendations addressed to Germany

On 11 July 2017, the Council addressed recommendations to Germany in the context of the European Semester.[4] In particular, in the area of public finances the Council recommended that Germany while respecting the medium-term objective, use fiscal and structural policies to support potential growth and domestic demand as well as to achieve a sustained upward trend in investment; accelerate public investment at all levels of government, especially in education, research and innovation, and address capacity and planning constraints for infrastructure investments; further improve the efficiency and investment-friendliness of the tax system.

4.1. Compliance with the debt criterion

As the debt ratio was 68.1% of GDP in 2016, Germany needs to comply with the debt reduction benchmark. The information provided in the no-policy-change DBP points to compliance with the debt reduction benchmark both in 2017 and 2018. This is in line with the Commission 2017 autumn forecast.

[4] Council Recommendation of 11 July 2017 on the 2017 National Reform Programme of Germany and delivering a Council opinion on the 2017 Stability Programme of Germany, OJ C 261, 9.8.2017.

Table 5. Compliance with the debt criterion

	2016	2017			2018		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	68.1	66 ¼	65¼	64.8	64	63¼	61.2
Gap to the debt benchmark [1,2]							
Structural adjustment [3]	0.1	-0.2	0.2	0.0	-0.3	-0.5	0.0
To be compared to:							
Required adjustment [4]							

Notes:

[1] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[2] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

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

[4] Defines the remaining minimum annual structural adjustment over the transition period which ensures that – if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.

Source:

Stability Programme 2017 (SP); Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations

4.2. Compliance with the MTO

Germany registered a structural surplus of 0.9% of GDP in 2016, well above its medium-term objective of a structural deficit not exceeding 0.5% of GDP. According to the information provided in the DBP, with a (recalculated) structural surplus of 1.0% and 0.5% of GDP, respectively, Germany is expected to remain above its MTO also in 2017 and 2018, which is equally confirmed by the Commission 2017 autumn forecast.

The projected margin to the MTO continues to provide scope to cover additional expenditure that may result in 2018 from continuing inflow of asylum seekers as well as to further stimulate potential growth, including through public investment in infrastructure, education, research and innovation, as recommended by the Council in the context of the European Semester.

Table 6: Compliance with the requirements of the preventive arm

(% of GDP)	2016	2017		2018	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	0.9	0.9		0.9	
Structural balance based on freezing (COM)	0.9	0.9		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2016**	**2017**		**2018**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]					
Required adjustment corrected[5]					
Change in structural balance[6]					
One-year deviation from the required adjustment[7]					
Two-year average deviation from the required adjustment[7]					
Expenditure benchmark pillar					
Applicable reference rate[8]					
One-year deviation adjusted for one-offs[9]	Compliant				
Two-year average deviation adjusted for one-offs[9]					
PER MEMORIAM: One-year deviation[10]					
PER MEMORIAM: Two-year average deviation[10]					
Conclusion					
Conclusion over one year					
Conclusion over two years					

Notes

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

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

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

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2016) was carried out on the basis of Commission 2017 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

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

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

Source:

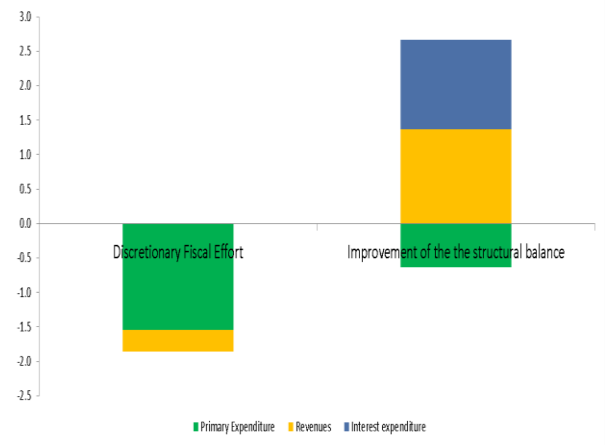
Draft Budgetary Plan for 2018 (DBP); Commission 2017 autumn forecast (COM); Commission calculations.

5. COMPOSITION OF PUBLIC FINANCES AND IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

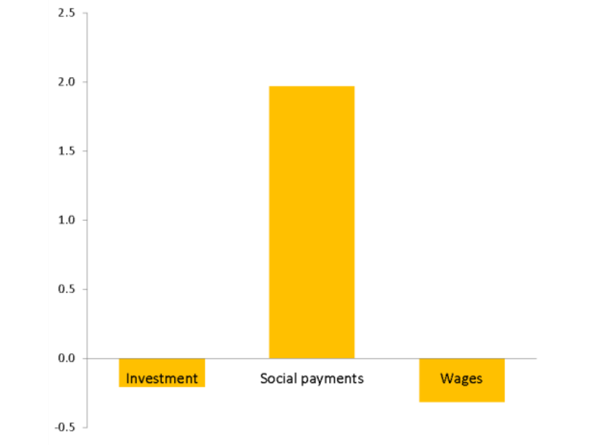
As in the year before also for 2017 and 2018, the DBP projects overall constant revenues at 45% of GDP and expenditure at 44¼%. Revenues are still expected to decline slightly in 2018, while cyclically-adjusted expenditure is to remain stable. Over 2011-2017 the discretionary fiscal effort (see graph 1) points to an expansionary fiscal policy, mainly due to primary expenditure increasing faster than medium-term growth and revenue decreasing measures. The structural balance nevertheless improved in this time because of strongly reduced interest expenditure as well as revenue windfalls.

Public investment is planned to remain overall stable at around 2¼% of GDP in 2017 and 2018 like in the year before, which is in line with the long-term average. This is also reflected in the change of the share in total expenditure since 2011 (see graph 2), where expenditure for investment and wages did not change much, while on the contrary for example payments for social payments increased markedly.

Graph 1: Composition of the fiscal effort (2011-2017), Germany (% GDP)



Graph 2: Change in the share in total expenditure of selected expenditure items (2011-2017), Germany (% change)



<u>Source</u>: Draft Budgetary Plans 2018, European Commission 2017 autumn forecast.

Note: Graph 1 shows the Discretionary Fiscal Effort (DFE) which combines a top-down approach on the expenditure side with a bottom-up or narrative approach on the revenue side. In a nutshell, the DFE consists of the increase in primary expenditure net of cyclical components relative to economic potential on the one hand, and of discretionary revenue measures on the other hand. See European Commission (2013): Measuring the fiscal effort, Report on Public Finances in EMU, part 3

http://ec.europa.eu/economy_finance/publications/european_economy/2013/pdf/ee-2013-4.pdf

The DBP includes measures taken in response to the country-specific recommendations issued in the broader area of public finances. In particular, a reform of fiscal relations has been agreed between the Federal Chancellor and the Minister-Presidents of the Länder which will take effect in 2020 and is expected to help complying with the national debt rule on all levels. Furthermore, from 2017 on additional funds will be provided for the modernisation and expansion of school buildings, including digital infrastructure. While these measures help to strengthen public investment, they are still insufficient to overcome the backlog in public infrastructure, especially at municipal level, that has accumulated over the last years.

The taxation system is in general complex and could be simplified and improved to support investment and the business environment. The act on the modernisation of taxation procedures aims at strengthening the digital and automatic processing of tax returns and places more emphasis on audits based on risk management.

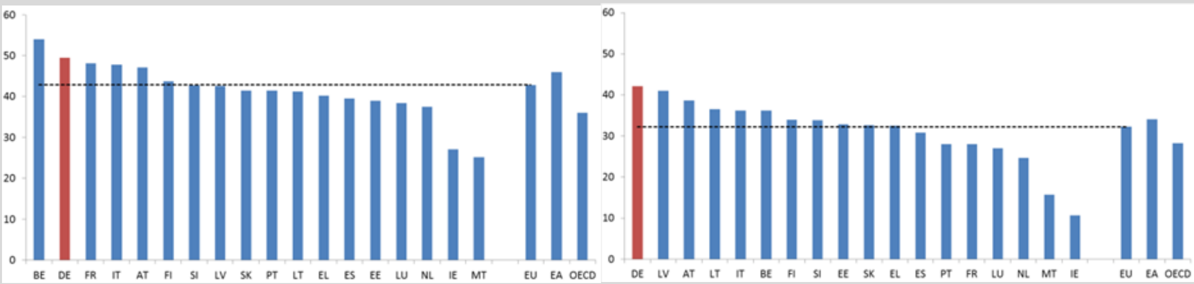
The tax wedge could be slightly reduced by increasing the basic personal allowance, the child tax exemption, the child benefit and the child supplement in 2017 and 2018 as well as a compensation for the impact of fiscal drag that has occurred over the last two years (see Box 3).

Box 3 – Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker's net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Germany for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

The tax burden on labour in Germany at the average wage and at low wage (2016)



Notes: No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

In the context of the 2017 European Semester, Germany was issued the recommendation to "Reduce disincentives to work for second earners and facilitate transitions to standard employment. Reduce the high tax wedge for low wage earner."

Germany's no-policy-change Draft Budgetary Plan contains the following measures that affect the tax wedge on labour by increasing in the basic personal tax-free allowance, child allowance, child benefit and supplementary child allowance in 2017 and 2018. It was also decided to adapt the income tax brackets to offset the effect of fiscal drag based on the preceding year's inflation rate. Overall, these measures will slightly reduce the tax wedge and thus contribute positively to growth and employment.

6. OVERALL CONCLUSION

According to both the information provided in the no-policy-change DBP and the Commission 2017 autumn forecast, the structural balance is projected to remain above the medium-term objective in 2017 and 2018, and the debt reduction benchmark is projected to be complied with in both years.