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COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of Germany

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of Germany

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1. INTRODUCTION

Germany submitted its Draft Budgetary Plan for 2020 on 15 October 2019 in compliance with Regulation (EU) No 473/2013. 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 .

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2019 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 2019 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 2019-2020 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations in the context of the European Semester adopted by the Council in July 2019, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

With a weak second half of 2019, the federal government expects gross domestic product to increase by only 0.5% in 2019. For the year 2020, an increase of 1.5% is expected. Industry is experiencing a pronounced period of weakness. Domestic demand remains the main driver of economic growth. Strong labour market, rising wages, and fiscal stimulus in line with the coalition agreement, support private consumption. However, the slowdown in world industrial production and world trade, dampen the export outlook and thus continue weighing on growth prospects.

Compared to the macro scenario of the 2019 Stability Programme, the growth projection has been revised downward by 0.5 percentage points for 2019 and 0.1 percentage points for 2020, reflecting the continued weakness in 2019, the deterioration of the external environment as well as the deterioration in business and consumer sentiment.

The macroeconomic scenario underpinning the Draft Budgetary Plan is based on the spring projection of the federal government published on 17 April 2019, and therefore does not

factor in the latest macroeconomic developments. The government has published an updated projection on 17 October 2019, after the submission of the Draft Budgetary Plan. The macroeconomic scenario underpinning the Draft Budgetary Plan is slightly more favourable compared to the more recent projection of the Commission 2019 autumn forecast expecting growth at 0.4% for 2019 and 1.0% for 2020 and, in addition, taking into account the benchmark revision of historical data. The weaker outlook of the Commission forecast for 2020, as compared to the scenario included in the Draft Budgetary Plan, is dictated by the protracted delay in the recovery in external demand and the continuing deterioration in business confidence, especially in manufacturing. In addition, it also includes a less optimistic labour market outlook.

All in all, the Draft Budgetary Plan is based on plausible macroeconomic assumptions until 2019 and favourable thereafter, in particular with respect to the assessment of the cyclical position in 2020 relative to the Commission 2019 autumn forecast[1].

Table 1. Comparison of macroeconomic developments and forecasts

	2018	2019			2020		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1.5	1.0	0.5	0.4	1.6	1.5	1.0
Private consumption (% change)	1.3	1.3	1.2	1.3	1.6	1.6	1.1
Gross fixed capital formation (% change)	3.5	2.4	2.2	2.5	2.7	2.8	1.5
Exports of goods and services (% change)	2.1	2.7	2.0	0.8	3.1	3.0	1.6
Imports of goods and services (% change)	3.6	4.0	3.8	2.5	4.0	4.0	2.7
Contributions to real GDP growth:							
- Final domestic demand	1.7	1.6	1.4	1.6	1.7	1.7	1.3
- Change in inventories	0.3	-0.2	-0.3	-0.5	0.0	0.0	0.1
- Net exports	-0.4	-0.3	-0.6	-0.6	-0.2	-0.2	-0.4
Output gap[1]	1.2	0.1	0.0	0.2	0.3	-0.2	-0.2
Employment (% change)	1.4	0.9	1.1	0.8	0.7	0.8	0.1
Unemployment rate (%)	3.4	3.0	2.9	3.2	2.8	2.7	3.4
Labour productivity (% change)	0.2	0.2	-0.6	-0.3	0.9	0.7	0.9
HICP inflation (%)	1.9			1.3			1.2
GDP deflator (% change)	1.5	2.1	2.3	2.0	2.0	2.0	2.0
Comp. of employees (per head, % change)	2.9	3.2	3.2	3.3	3.0	2.9	2.5
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	7.5	7.3	7.5	6.9	6.9	7.4	6.7

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 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

[1] The Draft Budgeary Plan assumes the output gap to increase from 0.1% in 2019 to 0.2% in 2020, while the output gap recalculated according to the commonly agreed methodology suggests a deterioration of the cyclical position (-0.2 percentage points) and the estimate by the Commission 2019 autumn forecast points to an even stronger deterioration (-0.4 percentage points).

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

According to the Regulation on the Economic Projections of the Federal Government (Vorausschätzungsverordnung) passed by the Ministry of the Economy and Energy in agreement with the Ministry of Finance and effective from July 2018, the Joint Economic Forecast project group has been named as the independent body in charge of assessing and endorsing the economic projections underlying the Draft Budgetary Plans and the Stability Programmes within the meaning of the Law on the Economic Projections (Vorausschätzungsgesetz) codifying the procedure for producing the government's economic forecasts and within the meaning of Regulation (EU) No 473/2013. The Joint Economic Forecast project group comprises the German Institute for Economic research in Berlin (DIW), the IFO institute in Munich, the Instiute for World Economy – Kiel, the Economic Research Insitute in Halle (IWH) and the Economic Research Insitute in Essen (RWI).

The Joint Economic Forecast project goup has endorsed the projection underlying the 2020 Draft Budgetary Plan on 17 April 2019 in a statement published on its website (gemeinschaftsdiagnose.de)[2] stating that "The projection of the Federal Government appears plausible against the background of the current information situation. The Joint Economic Forecast project goup supports this projection."

[2] For detailed documents see: http://gemeinschaftsdiagnose.de/2019/04/29/stellungnahme-der-projektgruppe-gemeinschaftsdiagnose-zur-fruehjahrsprojektion-2019-der-bundesregierung/

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

As usual the Draft Budgetary Plan reports on the budgetary situation of the general government, which comprises the federal government, regional governments, municipalities and social security funds. The Draft Budgetary Plan projects a general government headline budget surplus of 1¼ % of GDP for 2019 and ¾% of GDP in 2020.[3] Compared to the 2019 Stability Programme this projection is higher for 2019 (previously ¾% of GDP) while remaining the same for 2020. The difference is mainly due to better-than-expected social security contributions and tax revenues in 2019 as well as statistical revisions. Total revenue is higher by about 1% of GDP and total expenditure by about ½% of GDP due to higher social payments and intermediate consumption.

The Draft Budgetary Plan forecasts a decrease of the (recalculated) structural balance[4] from 1.4% of GDP in 2019 to 0.8% in 2020 in contrast to the 2019 Stability Programme, which projected a decrease of the (recalculated) structural balance from 0.8% of GDP in 2019 to 0.6% in 2020.

The Draft Budgetary Plan's fiscal projections for 2019 are broadly in line with the Commission 2019 autumn forecast, which expects a headline surplus of 1.2% of GDP and a structural surplus of 1.1% of GDP. Similarly, the Draft Budgetary Plan fiscal projections for 2020 are close to the Commission forecast, which projects a headline surplus of 0.6% of GDP and a structural surplus of 0.7% of GDP, based on a no-policy-change assumption. The differences in 2019 can be explained by the slightly less favourable macroeconomic outlook of the Commission 2019 autumn forecast and the slightly higher expectations as regards the increase in overall government expenditure for social payments and compensation of employees.

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Germany currently standing at -0.35[5]. 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 remain relatively low at ¾% of GDP in 2019 and 2020, well below the 2.3% of GDP recorded in 2012 at the peak of the euro area sovereign debt crisis. The picture stemming from Member States' plans is broadly confirmed by the Commission forecast.

Against the background of continuing low interest expenditure, the projected development of the structural balance (-0.0% in 2019 and -0.6% of GDP in 2020) is accompanied by a slightly more pronounced reduction in the structural primary balance (-0.2% and -0.7% of GDP, respectively).

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

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

[5] 10-year bond yields as of 28 October 2019. Source: Bloomberg.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2018	2019			2020			Change: 2018-2020
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**46.4**	**45½**	**46½**	**46.5**	**45¼**	**46¼**	**46.3**	**-¼**
of which:								
- Taxes on production and imports	10.6	10½	10½	10.6	10½	10½	10.6	0
- Current taxes on income, wealth, etc.	13.3	13¼	13¼	13.3	13¼	13¼	13.2	-¼
- Capital taxes	0.2	0	¼	0.2	0	¼	0.2	0
- Social contributions	17.1	17.0	17¼	17.4	17.0	17¼	17.3	¼
- Other (residual)	5.2	4¾	5¼	5.1	4¾	5	5.0	-¼
Expenditure	**44.6**	**44½**	**45¼**	**45.3**	**44½**	**45½**	**45.7**	**1**
of which:								
- Primary expenditure	43.6	43.8	44.4	44.4	43.8	44.8	44.9	1¼
of which:								
Compensation of employees	7.8	7½	7¾	7.9	7½	7¾	7.9	0
Intermediate consumption	5.1	5	5¼	5.2	5	5¼	5.2	¼
Social payments	24.1	24¼	24½	24.6	24¼	24¾	24.8	½
Subsidies	0.9	¾	1.0	0.9	¾	1.0	0.9	¼
Gross fixed capital formation	2.4	2½	2½	2.5	2½	2½	2.6	¼
Other (residual)	3.4	3¾	3½	3.4	3¾	3½	3.5	¼
- Interest expenditure	0.9	¾	¾	0.9	¾	¾	0.8	-¼
General government balance (GGB)	**1.9**	¾	**1¼**	**1.2**	¾	¾	**0.6**	**-1¼**
Primary balance	**2.8**	**1¾**	**2¼**	**2.1**	**1½**	**1½**	**1.4**	**-1½**
One-off and other temporary measures	-0.2	0	0	0	0	0	0	¼
GGB excl. one-offs	**2.0**	¾	**1½**	**1.2**	¾	¾	**0.6**	**-1¼**
Output gap[1]	1.2	0.1	0	0.2	0.3	-0.2	-0.2	-1.4
Cyclically-adjusted balance[1]	1.3	0.8	1.4	1.1	0.6	0.8	0.7	-0.5
Structural balance (SB)[2]	**1.4**	**0.8**	**1.4**	**1.1**	**0.6**	**0.8**	**0.7**	**-0.6**
Structural primary balance[2]	2.4	1.7	2.2	2.0	1.4	1.5	1.5	-0.9

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 corresponds to cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

Based on the Draft Budgetary Plan, Germany plans to comply with the requirements of the applicable national numerical fiscal rules, in particular with the constitutional 'debt brake' which provides that the federal budget as of 2016 must not exceed a deficit of 0.35% of GDP.[6] At its 19th meeting on 18 June 2019 the Fiscal Council (Stabilitätsrat) concluded that

[6] The constitutional 'debt brake' provides that since 2016 the structural balance of the federal budget must not exceed a deficit of 0.35% of GDP. The federal states must have structurally balanced budgets as of 2020.

the federal government adhered to the national fiscal rules in the year 2018 and was expected to do so in 2019 and 2020.[7]

3.2. Debt developments

The debt-to-GDP ratio decreased by 3.4% of GDP to 61.9% in 2018. The Draft Budgetary Plan projects the debt-to-GDP ratio to decline further to 59¾% of GDP in 2019 and 57¾% in 2020, owing to the budget surplus and the positive denominator effect of nominal GDP growth. The debt projections are slightly less positive compared to those of the 2019 Stability Programme and also compared to the Commission 2019 autumn forecast, which project a slightly stronger decline of the debt ratio in 2019 and 2020.

Table 3. Debt developments

(% of GDP)	2018	2019			2020		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**61.9**	**58¾**	**59¾**	**59.2**	**56½**	**57¾**	**56.8**
Change in the ratio	-3.4	-3¼	-2¼	-2.7	-2	-2	-2.4
Contributions[2]:							
1. Primary balance	**-2.8**	**-1¾**	**-2¼**	**-2.1**	**-1½**	**-1½**	**-1.4**
2. "Snow-ball" effect	**-1.0**	**-1**	**-1**	**-0.6**	**-1¼**	**-1¼**	**-1.0**
Of which:							
Interest expenditure	0.9	0.0	0.0	0.0	0.0	0.0	0.0
Real growth effect	-1.0	-0.6	-0.3	-0.3	-0.9	-0.9	-0.6
Inflation effect	-1.0	-1.2	-1.4	-1.2	-1.1	-1.2	-1.2
3. Stock-flow adjustment	**0.4**	**-0.5**	**0.9**	**0.0**	**0.7**	**0.7**	**0.0**
Of which:							
Cash/accruals difference							
Net accumulation of financial assets							
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 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations

[7] For the national stability report see: https://www.stabilitaetsrat.de/SharedDocs/Downloads/DE/keine_Dokumentensuche/Parlamentsdokumente/20190618/20190618_TOP1.pdf?__blob=publicationFile

3.3. Measures underpinning the draft budgetary plan

The fiscal stance is expansionary in 2020, as many of the planned government measures of the March 2018 coalition agreement show their effect. According to the Draft Budgetary Plan, the structural surplus is planned to be reduced by 0.6% of GDP in 2020. The Commission 2019 autumn forecast expects the fiscal expansion to be more evenly distributed between 2019 and 2020, with the structural surplus decreasing by 0.3% of GDP in 2019 and by 0.4% in 2020, reaching 0.7% of GDP in 2020. This decline in the structural balance is mainly driven by previously agreed measures to lower income taxation and increase social benefits for families as well as in general slowing growth in tax revenues.

The Draft Budgetary Plan lists as new government measures the Climate Action Programme 2030 that will have an expansionary fiscal impact in 2020 of around 0.1% of GDP, contributing to the overall fiscal expansion of 0.6% of GDP in that year. This climate programme incorporates already existing initiatives and new measures. The new measures comprise the introduction of a CO_2 pricing for the sectors not covered by the EU Emission Trading System as well as various subsidies and support programmes to encourage environmentally friendly behaviour, notably cheaper railway ticket prices, subsidies for electric mobility and support for renewable energies. As the objective of the Climate Action Programme 2030 is to be financed as far as possible in a budgetary neutral way, the overall budgetary effect on the fiscal stance after 2020 is expected to be small.

Moreover, the Draft Budgetary Plan lists a variety of further measures, which were part of the March 2018 coalition agreement and that take effect as of 2019 and 2020. These measures aim to strengthen investment in the areas of education, research, innovation and digital technologies. Families and children are supported by better childcare facilities, increased social benefits and tax reliefs. Lower income tax and social security contributions benefit especially low- and middle-income earners. Increased investment grants targeting transport, services in rural areas, structurally weak regions and local authorities are set to support equal living conditions throughout the country. Moreover, the Draft Budgetary Plan lists several measures that have been announced or are yet to be adopted. These measures include additional funds to support the economic change in former coal mining areas, an overhaul of the competition framework intended to attract more private investment, tax credits for companies conducting research and development activities as well as strategies for digitisation, blockchain and artificial intelligence.

The following table summarises the newly adopted measures since the last Stability Programme from April 2019, consisting mainly of the Climate Action Programme 2030 together with other already existing measures to protect the climate included in the baseline budgetary projection.

Table 4. Main discretionary measures reported in the Draft Budgetary Plan

A. Discretionary measures taken by General Government - revenue side

Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2019	**2020**
Taxes on production and imports		0.1
Current taxes on income, wealth, etc.		0.0
Capital taxes		
Social contributions		
Property Income		
Other		
Total		**0.1**

Note:

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

Source:

Draft Budgetary Plan for 2020

B. Discretionary measures taken by general Government- expenditure side

Discretionary measures taken by General Government - expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2019	**2020**
Compensation of employees		
Intermediate consumption		0.1
Social payments		
Interest Expenditure		
Subsidies		
Gross fixed capital formation		0.0
Capital transfers		0.0
Other		0.1
Total		**0.2**

Note:

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

Source:

Draft Budgetary Plan for 2020

The Country-Specific Recommendations issued by the Council on 9 July 2019[8] call on Germany to, while respecting the medium-term budgetary objective, use fiscal and structural policies to achieve a sustained upward trend in private and public investment, in particular at regional and municipal level. Germany is called to focus investment-related economic policy on education; research and innovation; digitalisation and very-high capacity broadband; sustainable transport as well as energy networks and affordable housing, taking into account regional disparities. Reflecting these recommendations, the Draft Budgetary Plan shows increasing investment expenditure for digital and transport infrastructure as well as additional funds for education, research and innovation. Those measures are expected to be beneficial for supporting inclusive and sustainable growth as well as domestic demand. Measures to reduce the tax wedge, especially for families as well as low- and medium-income earners will benefit private consumption and further increase domestic demand. Based on the Draft Budgetary Plan, public investment is expected to attain 2½% of GDP in 2019 and 2020, slightly above the long-term average since 2000 of 2¼% of GDP. This compares to an average of 2¾% of GDP in 2018 in the rest of the euro area without Germany. Likewise he Commission 2019 autumn forecast projects public investment to grow by 7.7% in 2019 and 6.7% in 2020. However, due to limited capacities in the construction and public works sector, this additional spending might contribute more to rising prices than to volumes. Further efforts to improve capacities are needed, which should allow to reap full benefit of the available funds and to increase public investment in a sustained manner and 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 those measures.

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

Germany is subject to the preventive arm of the Pact and should ensure compliance with its medium-term budgetary objective.

Germany registered a structural surplus of 1.4% of GDP in 2018, well above its medium-term objective of a structural deficit not exceeding 0.5% of GDP. According to the information provided in the Draft Budgetary Plan in 2019 and 2020, Germany is expected to remain well above its medium-term budgetary objective with a (recalculated) structural surplus of 1.4% and 0.8% of GDP respectively, which is confirmed by the Commission 2019 autumn forecast.

The projected margin to the medium-term budgetary objective should be used for additional expenditure to achieve a sustained upward trend in private and public investment, as recommended by the Council in the context of the European Semester.

Germany is projected to achieve a debt-to-GDP-ratio below the 60% Treaty reference value in 2019 with a further decline in 2020, implying compliance with the provisions of the Stability and Growth Pact with regard to the debt criterion. This is in line with the Commission 2019 autumn forecast.

[8] Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Germany and delivering a Council opinion on the 2019 Stability Programme of Germany, OJ C 301, 5.9.2019, p. 24.

Table 5. Compliance with the requirements of the preventive arm

(% of GDP)	2018	2019		2020	
Initial position[1]					
Medium-term budgetary objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	1.4	1.1		0.7	
Structural balance based on freezing (COM)	1.4	1.1		-	
Position vis-a -vis the MTO[3]	MTO	At or above the MTO		At or above the MTO	
	2018	**2019**		**2020**	
(% of GDP)	**COM**	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar	**Compliant**				
Required adjustment[4]					
Required adjustment corrected[5]					
Change in structural balance[6]					
One-year deviation from the required adjustment[7] *adjustment*[7]					
Expenditure benchmark pillar					
Applicable reference rate[8]					
One-year deviation adjusted for one-offs[9]					
Two-year average deviation adjusted for one-offs[9]					

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 is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance corresponds to 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 ed. 2018, 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 2018) was carried out on the basis of Commission 2019 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.

Source :
Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations.

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

The Draft Budgetary Plan projects slightly higher revenues and noticeably higher expenditures for 2019 at 46½% and 45¼% of GDP respectively compared to 2018 at 46.4% and 44.6% respectively. The higher revenues are mainly due to better-than-expected taxes on income and wealth, whereas the growing government spending reflects the starting process of implementing the agreed measures of the March 2018 coalition agreement. For 2020, the Draft Budgetary Plan projects slightly lower revenues at 46¼% and slightly growing expenditure at 45½% as the implementation of the agreed coalition measures continues. The structural balance is thus projected to remain stable in 2019 at 1.4% of GDP, before declining noticeably in 2020 by 0.6% of GDP.

Public investment is planned to accelerate to 2½% of GDP in 2019 and 2020, slightly higher than in 2018 at 2.4% of GDP, exceeding the long-term average since 2000 of 2.2% of GDP.

The Draft Budgetary Plan includes measures taken in response to the country-specific recommendations issued in the broader area of public finances. A fund for Digital Infrastructure is targeted to provide a very high-capacity broadband infrastructure nationwide. Measures to improve childcare facilities, support for education and training as well as tax credits for research and development activities follow the recommendation for stronger public investment in education and research and innovation. Innovation is also supported by special strategies for digitisation, blockchain and artificial intelligence. While those measures help to strengthen public investment, they are still insufficient to overcome the backlog in public infrastructure investment, especially at municipal level, that has accumulated over recent years.

The Draft Budgetary Plan includes as new measures the Climate Action Programme 2030 that together with other existing measures to protect the climate regroups explicitly environmentally friendly measures and their mode of financing. On the revenue side it lists the EU Emission Trading System and a CO_2 pricing, that functions similar to a tax, as main financial sources to finance in a budgetary neutral way various expenditures to support environmentally friendly behaviour. Measures on the revenue side include for example tax reliefs for retrofitting of buildings, electric mobility or cheaper train tickets. On the expenditure side, measures include several support programmes for implementing climate-friendly measures by the government including promoting rail transport.

The Act to accelerate the power grid expansion as well as the plan to improve the Liquefied Natural Gas infrastructure aim to increase the country's sustainable growth capacities. The Act on structural change in coal mining areas as well as a commission on equal living standards contribute to more inclusive growth in the country by supporting structurally weak regions. Inclusive growth is also supported by social legislation to increase the general minimum wage as well as a housing and rental package to increase affordable housing. Plans to introduce a basic pension 10% above old-age basic income support is intended to increase the fairness of the pension system by acknowledging the contributions made by people having worked long time. The national strategy for continued training and other support measures to increase education and skills for disadvantaged groups to increase their labour market chances contribute to more inclusive growth.

The taxation system is in general complex and could be simplified and improved to support investment and the business environment. The tax burden on labour and the tax wedge are in general high in Germany, when placed in international comparison, which are driven to a large extent by social security contributions besides income tax. Measures increasing the basic personal tax-free allowance, the child benefit and tax-free child allowance as well as the offsetting of the tax bracket creep will reduce the tax wedge. The equal financing of the health insurance system by employers and employees as well as the reduction of the contributions to the unemployment insurance and further relief of social security contributions for low paid jobs and so called midi-jobs will benefit above all low- and middle-income earners (see Box 2).

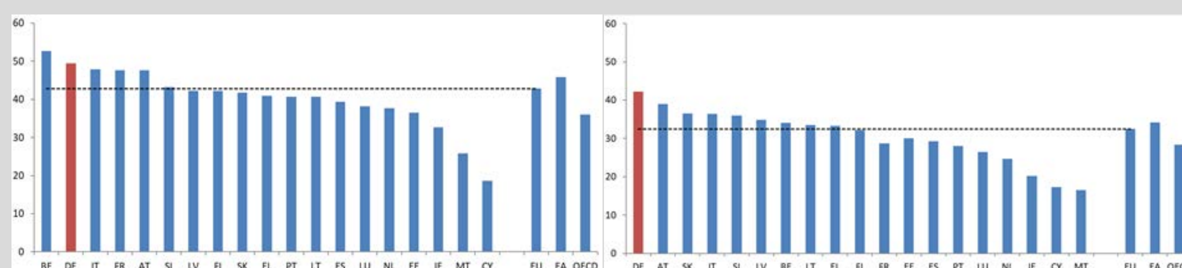
These various measures listed in the Draft Budgetary Plan address the fiscal-structural recommendations adopted by the Council to some extent, however more and continued efforts are needed by Germany to fully implement these recommendations.

Box 2: 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 (2018)



Notes: 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 2019 European Semester, Germany was issued the recommendation to reduce disincentives to work more hours, including the high tax wedge, in particular for low-wage and second earners.

Germany's Draft Budgetary Plan contains the following measures to reduce the tax wedge on labour: increasing the basic personal tax-free allowance, the child benefit and tax-free child allowance as well as offsetting of the tax bracket creep. The reduction of the contributions to the unemployment insurance by 0.5 percentage point as well as the return to the equal funding of the health insurance system by employers and employees and other relief measures support the lowering of the tax wedge from the side of social security contributions especially for low- and middle-income earners. These reductions are counterbalanced by higher contributions to long-term care insurance by 0.5 percentage point. Overall, those measures are expected to positively contribute to growth and employment.

6. OVERALL CONCLUSION

According to both the information provided in the Draft Budgetary Plan and the Commission 2019 autumn forecast, the structural balance is projected to remain above the medium-term budgetary objective in both 2019 and 2020. The debt-to-GDP-ratio is projected to fall below the 60% Treaty reference value in 2019 and to continue declining further in 2020, implying compliance with the debt criterion.