Stabilitätsrat
Unabhängiger Beirat

13th Statement

on compliance with the upper limit to the structural general government budget deficit

pursuant to Section 51 (2) of the Budgetary Principles Act (HGrG)

Final version, 18 June 2020

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1. Summary and assessment

The COVID-19 pandemic and the measures to contain it have triggered a massive recession worldwide. Accordingly, the spring projection by the federal government currently reflects sharply underutilised capacities for the German economy. Following the low point in the current year, the federal government expects a gradual recovery. **The Advisory Board considers the federal government's macroeconomic projection including potential output acceptable.** In doing so, the Advisory Board duly took account of the immense uncertainty in the context of which this projection was prepared. It can safely be assumed that the macroeconomic development expected will continually need to be revised against the backdrop of new information available from time to time.

No consistent fiscal estimate was submitted to the Stability Council. Instead, only a calculatory update of the older projection under the Stability Programme was presented, which is confined to the structural deficit in the year 2020. This is quantified with 5½% of GDP. **According to calculations by the Advisory Board, an unadjusted deficit quota of 8½% is likely to be behind this, which is at the upper margin of the spectrum for comparison purposes of other institutions. However, the Advisory Board believes this size category certainly is possible.** This applies all the more since the most recently agreed economic stimulus package was not yet taken into consideration in this regard. The deficit could extend in the year 2020 beyond 9% of GDP, based on the calculatory update.

The structural deficit will exceed the regular upper limit of 0.5% of GDP to a considerable degree in the current year. According to the resolution proposal, the Stability Council does not consider this excess a violation of fiscal rules since the national regulation is based on European provisions, to which an escape clause applies at present. **In the present extraordinary and crisis-like circumstances, the Advisory Board considers recourse to the escape clause to be correct.** The upper limit to the structural budget deficit therefore currently does not need to be complied with, and at present no consolidation measures need to be adopted for correction purposes.

However, the Advisory Board points out that the escape clause **will not tolerate credit-financed expenditure or tax cuts to any desired extent**. The purpose of the escape clause is to ensure the ability of the state to take specific, targeted action to overcome the crisis. In addition to support measures and liquidity assistance for enterprises, economic stimulus measures have now been adopted by the federal government. This has been underpinned by an expansion of support programmes within the scope of the federal government's extra-budgetary funds. In the present situation, there is uncertainty regarding the cyclical impacts of the discretionary economic stimulus measures. **However, in view of the crisis-like situation, the Advisory Board considers the type and scope of deficit-effective measures adopted thus far to be acceptable.**

Contrary to the applicable provisions, the Stability Council did not submit an estimate for the coming four years. The Stability council justifies this by arguing that an estimate of this kind would not be meaningful at this time due to the inadequately reliable data status and the prevailing dynamic development. To the Advisory Board, in view of the very high level of uncertainty it is understandable from an economic perspective to dispense with the need to submit medium-term fiscal policy recommendations for action at present. **However, the Stability Council should clarify that the deviation from the upper limit for the structural budget balance will be corrected in line with European provisions as soon as the exceptional situation no longer exists.** A corresponding explanation by the Stability Council would be an important contribution towards alleviating concerns of a destabilisation of public finances.

Verification of compliance with rules and regulations will be considerably more sophisticated in the future than in the preceding years in which economic and budgetary development was comparatively good. Challenges will arise not least due to deviating provisions between national and European budgetary rules. This applies in particular with regard to the specific provisions on the consolidation paths and the partly different delineations and calculation methods used. **Accordingly, it is all the more urgent now to ensure a good, reliable data and information basis.** In previous statements, the Advisory Board pointed out the current gaps and problems and submitted proposals.

The Advisory Board points out that the fiscal risks cannot be gauged by means of the structural deficit quota alone. For the year 2020, the federal government expects a debt-to-GDP ratio in the order of 75%. However, this value does not yet include the measures adopted since April, including the economic stimulus package. At the same time, the federal and state governments issue extensive guarantees and equity capital for companies and there are high authorisation limits in place. This could give rise to greater risks than in the past.

The national rules provide for the repayment of extraordinary, crisis-related debt. The federal government has stipulated that such repayment will be made over a period of 20 years. The federal states have selected quite different periods of up to 50 years. The Advisory Board notes that very long repayment periods can endanger the long-term sustainability of public-sector budgets and future compliance with debt limits, especially when above-average indebtedness already existed at the outset.

The Advisory Board also refers to the particular problems at municipal level. In the event of crisis-related burdens on its budgets, local government cannot resort to exceptional clauses. In order to avoid a sharp, short-term consolidation (e.g. due to shortfalls in investments) or an alarming flight into cash loans, financial support of municipalities will be necessary. **The Advisory Board considers the arrangements made in this regard as part of the economic stimulus package to be quite justified.**

At present, the Advisory Board considers an extensive stabilisation of the economy via public finances as the correct approach to follow. At the same time, the Advisory Board points out an eye will need to be kept on future (in particular, demographic) challenges with regard to public finances. Existing problems will be exacerbated by the impacts of the corona crisis. This applies in particular to statutory pension and health insurance. **From the Advisory Board's perspective, it will need to be established in the further course of events how the impending substantial increases in social security contribution rates are to be dealt with.**

The European Commission proposes that € 750 billion in debt will need to be taken out to finance the EU budget. Of this sum, € 500 billion is to be utilised for transfers. Measured based on its GDP share, approx. € 125 billion of this sum would need to be apportioned to Germany. **The design and extent of possible transfers at European level will ultimately need to be decided in political terms. From the Advisory Board's perspective, however, extensive borrowing at EU level entails a number of risks.** Care must be taken to ensure that future burdens will be transparently reflected; after all, a corresponding volume of funding will be required in the further course of time. Without this transparency, there is a danger of a 'debt illusion' that would further undermine the existing fiscal rules.

2. Preliminary notes

The Advisory Board supports the Stability Council in monitoring compliance with the upper limit of the structural general government budget deficit pursuant to Section 51 (2) of the Budgetary Principles Act (HGrG) in accordance with Section 6 of the Stability Council Act. To this end, the Advisory Board issues a statement on the question of compliance with this upper limit prior to the relevant resolution being adopted by the Stability Council.

The **proposed resolution for the Stability Council on 22 June 2020 contains findings on the upper limit being exceeded in the year 2020.** Taking reference to an inadequately reliable data situation and dynamic development, **no statement has been made on the financial situation in the coming years and on compliance with the upper limit for the years 2021 to 2024**.

The statement by the Advisory Board only takes account of information available as at 17 June 2020. This comprises, *inter alia*, the following public information:

- The proposed resolution by the Working Group (WG) of the Stability Council of 4 May 2020 for the meeting of the Stability Council on 22 June 2020;
- The German Stability Programme 2020 of April 2020, based on the projection by the federal government for the act concerning a supplementary budget for the year 2020 of March 2020 as well as German Draft Budgetary Plan 2020 ,of October 2019;
- The spring projection by the federal government on macroeconomic development of 29 April 2020 and the tax estimate by the Working Group on Tax Estimates of 12 to 14 May 2020;
- The projections by the European Commission (May 2020), the Joint Economic Forecast (JEF, April 2020), the German Council of Economic Experts (GCEE, March 2020), Deutsche Bundesbank (May 2020), the International Monetary Fund (IMF, April 2020) and the Organisation for Economic Co-operation and Development (OECD, June 2020);
- Public-sector budgetary outcomes according to the national accounts and as defined by the Maastricht Treaty and according to the financial statistics as of May 2020;
- Outcome of the coalition committee meeting of 3 June 2020;
- Draft of a second supplement to the federal budget of 16 June 2020.

Additional background information was provided by the Federal Ministry of Finance (BMF) and the Central Data Office of the State Finance Ministers (ZDL) for internal use by the Advisory Board, which was taken into account in the analysis.

In its assessment of the Stability Council's consultancy document, the Advisory Board refers – unless otherwise indicated – to the solution proposal by the WG of the Stability Council of 4 May 2020 for the meeting of the Stability Council on 22 June 2020 and, in particular, to the spring projection on macroeconomic development by the federal government and to the calculatory updated of the fiscal projection contained in the Stability Programme.

Due to the COVID-19 pandemic, the data basis for preparing the statement differs from that of the past several years. An interim forecast on macroeconomic development was prepared by the federal government in March 2020 for the supplement to the federal budget for the year 2020. The fiscal projections of the German Stability Programme 2020 of April 2020 are based on this preliminary estimate. In conformity with the *Guidelines for a streamlined format of the 2020 Stability and Convergence Programmes in light of the COVID-19 outbreak* on the part of the European Commission, all projections listed therein are confined to the current year.

In addition to the federal government, the federal states have implemented strategies to combat the economic consequences of the COVID-19 pandemic. In the projection of the general government budget balance submitted by the BMF, these measures have been included up to 27 March 2020. Additional measures until 29 April have been included in the calculatory update.

3. Budget outcomes in 2019

In 2019, Germany met the provisions laid down by the Stability and Growth Pact and the European Fiscal Compact. According to the latest calculation by the European Commission, the structural budget balance for the year 2019, adjusted for cyclical effects and temporary measures, amounted to +0.9% of Gross Domestic Product (GDP) (cf. Overview 1). The BMF determined a value of +0.5% of GDP, based on the spring projection 2020 by the federal government. The surplus therefore more or less corresponded to the forecast submitted to the Stability Council in November 2018 (+½% of GDP). In the process, two deviations compensated each other in comparison with November 2018. For one thing, the unadjusted balance turned out considerably more positive than had still been expected in 2018. For another, however, a considerably higher macroeconomic degree of capacity utilisation has now been applied – i.e. a larger portion of the surplus is classified as cyclical in nature. The reason given for this is that due to the corona crisis, the growth path of potential output has been shifted downwards for the economy as a whole – including the potential output for 2019. The upper limit for the structural budget deficit amounting to 0.5% of GDP (which corresponds to a structural budget balance equivalent to -0.5% of GDP) was complied with by a significant margin.

The debt-to-GDP ratio according to the Maastricht delineation declined by 2.1 percentage points last year. The general government surplus and, in particular, the positive macroeconomic development, increasing nominal GDP as a reference value in the denominator, made a significant contribution in this regard. **At the end of 2019 the debt-to-GDP ratio came to 59.8%. Accordingly, it fell below the upper limit of 60% fixed in the European fiscal rules for the first time since the year 2002.**

Overview 1: Forecast/actual comparison for the structural budget balance1)

In % of GDP, for 2019	Forecast	Forecast	Actual	Actual
	(autumn 2018) BMF	(autumn 2019) BMF	(spring 2020) BMF2)	(spring 2020) European Commission
1. Budget balance	1	1½	1.4	1.4
2. Cyclical component	0.3	0.2	1.0	0.5
3. Cyclically adjusted balance	½	1¼	0.5	0.9
4. One-off and temporary measures	0	0	0.0	0
5. Structural budget balance	**½**	**1¼**	**0.5**	**0.9**
6. Cyclically adjusted primary balance3)	1½	2¼	1.3	1.7
7. Output gap4)	0.6	0.4	1.9	1.0

1) The figures for the BMF forecasts were derived from the 10th and 12th statement by the Independent Advisory Board of the Stability Council. – **2)** The figures presented are based on the calculatory update submitted by the BMF, the spring projection by the federal government of macroeconomic development dated 29 April 2020 as well as own calculations by the Advisory Board. – **3)** The primary balance reflects the balance without taking account of interest expenditure. – **4)** In % of potential output.

4. On the macroeconomic projection by the federal government of April 2020

a) On macroeconomic development

Brief description of the projection by the federal government[1]

The COVID-19 pandemic and the measures to contain it have resulted in a sharp recession – not only in Germany but worldwide. In its spring projection, the federal government expects a decline in price-adjusted GDP by 6.3% in the current year (cf. Overview 2). According to the projection, in 2021 the German economy will recover and macroeconomic output will increase by 5.2%. In the medium term in the years 2022 to 2024, the recovery will continue with growth rates of 1.4% per annum. However, according to the assessment by the federal government, in the medium term the output of goods and services will not reach the level expected prior to the outbreak of the corona crisis. Compared to the projection of autumn 2019, according to the current assessment the level of price-adjusted GDP in 2024 will be 3.0% lower. The cyclical downturn this year is attributable above all to a substantial decline in domestic absorption. Both equipment investment and private consumption are declining more sharply than GDP. Not least, a declining global economy will cause exports of goods and services to see a substantial decline.

For consumer prices (deflator of private consumption), the federal government expects an increase of 0.3% this year and 1.4% in the year thereafter. The GDP deflator will rise considerably more sharply at 1.7% this year. The decisive factor for this discrepancy are terms-of-trade effects

[1] Cf. Project Group Joint Economic Forecast (2020): "Stellungnahme der Projektgruppe Gemeinschaftsdiagnose zur Frühjahrsprojektion 2020 der Bundesregierung" (Statement by the Project Group Joint Economic Forecast on the 2020 spring projection by the federal government), Munich.

since crude oil prices fell considerably at the beginning of the year 2020, in tandem with import prices. In the medium term, an increase of 1.6% per annum is anticipated for consumer prices and the GDP deflator, slightly lower than in the projections of last autumn (1.7%) and spring (1.8%). According to the current projection, a growth rate of nominal GDP of 3.0% per annum is anticipated as of 2022.

According to the federal government, due to the macroeconomic slump, this year the number of employees will decline for the first time since the year 2005. At the same time, the unemployment rate, in delineation from the International Labour Organization (ILO), will rise to 3.8%. Employment next year will increase again in the wake of the recovery, with a corresponding decline in the unemployment rate. However, the dynamic movements on the labour market will remain significantly weaker than before the crisis. A contributory factor in this regard – irrespective of the corona crisis – is the intensifying demographic change amid a decline in net migration, which means that on balance, employment in the medium term as of 2022 will see a declining trend. According to the assessment by the federal government, this year gross wages and salaries per employee will decline for the very first time since Germany's reunification. In particular, the sharp increase in short-time work is discernible in this context. While short-time work will not impact the number of employees, it is exerting pressure on gross wages and salaries, while short-time work compensation paid in lieu of wages is part of monetary social benefits. The medium-term projection shows that gross wages and salaries per employee will rise at a rate of 3%.

Assessment

The present forecasts and projections differ significantly with respect to macroeconomic development in Germany (cf. Overview 2). Particularly high uncertainty prevailed in the case of the projections published until early April – such as that of the GCEE of 30 March and the JEF of 8 April – about the duration of the shutdown and the associated decline in economic output. For this reason, the GCEE submitted a scenario calculation. Projections submitted at a later date (such as that of the federal government of 29 April or of the European Commission of 6 May) turned out more pessimistic not least because the lengthier shutdown phase and the slower restart of the economy were already becoming evident. Moreover, different assumptions were made in the individual projections with regard to the speed of the economic recovery following the end of the shutdown. While according to the GCEE and the JEF, the growth rate in 2021 will exceed the decline in the previous year, the recovery is turning out to be considerably weaker according to the other projections.

Moreover, the high level of uncertainty at present reflects the extraordinarily wide range of GDP forecasts prepared for Germany by Consensus Economics. Compared to the situation at the beginning of the year, the distance between the most optimistic and the most pessimistic forecast for the year 2020 increased from 1.6 percentage points (-0.2% to +1.4%) to 8.7 percentage points (-1.3% to -10.0%) in April. During the Great Recession in the spring of 2009, this bandwidth of GDP forecasts for the current year only just reached 4 percentage points (-3.0% to -7.0%). In addition, there is immense uncertainty concerning the speed of the economic recovery. In April, the range of GDP forecasts for the coming year came to 9.5 percentage points (+0.5% to +10.0%) and was thus considerably wider than in the spring of 2009, when it amounted to as little as 3.5 percentage points (-1.5% to +2.0%). A consensus is lacking especially as far as the speed of recovery is concerned. Half of the experts surveyed expect a GDP increase for the year 2021 that will be at least as high as the decline this year. For the other half, it is clear that in the next year output of goods and services will be much below the pre-crisis level – the output level for 2021 is partly being assessed as substantially lower.

On the whole, against the backdrop of the high level of forecast uncertainty and the many assumptions to be made regarding the further course of infections and the extent and effectiveness of health-related and economic policy measures, the projection submitted by the federal government certainly describes a plausible development. References were made to the numerous risks involved in the economic forecasts in all projections received to date. For instance, a further prolongation of the shutdown, a slower easing of measures or a second wave of infections may impair economic development not only directly due to extended production stoppages. Moreover, the subsequent recovery may slow down significantly as the restoration of supply chains is being impeded and a spike in corporate insolvencies is becoming more probable. It is unclear whether the corona crisis will be accompanied by effects that will hurt output permanently and would justify an economic recovery in the direction of decreased potential output. The federal government's recently agreed economic stimulus package is likely to yield positive impetus to foster economic development. In a first rough estimate, for instance, Deutsche Bundesbank expects that (in relation to its baseline excluding these measures) this might lead to GDP in real terms turning out higher by more than one per cent in the current year and about half a per cent next year.[2]

[2] The growth rates in the current year would therefore be correspondingly higher, but lower in the following year. Cf.: Deutsche Bundesbank, Outlook for the German economy for 2020 to 2022, Monthly Report June 2020, pp. 14 ff.

Overview 2: Current[1)] projections of macroeconomic development

Year-on-year percentage change (unless otherwise stated)	2019	2020	2021	2022	2023	2024
1. Federal government (April 2020)						
1aa. GDP, price-adjusted	0.6	-6.3	5.2	1.4	1.4	1.4
1ab. GDP deflator	2.2	1.7	1.5	1.6	1.6	1.6
1ba. Private consumption, price-adjusted	1.6	-7.4	6.5	1.3	1.3	1.3
1bb. Private consumption, deflator	1.3	0.3	1.4	1.6	1.6	1.6
1c. Gross wages and salaries per employee[2)]	3.1	-0.9	3.8	3.0	3.0	3.0
1d. Employees	1.2	-0.5	0.2	-0.2	-0.2	-0.2
1e. Unemployment rate in % (acc. to ILO[3)])	3.0	3.8	3.4	3.6	3.7	3.7
1f. Short-term interest rates in % (technical assumption)	0.0	0.0	0.0	0.0	0.0	0.0
2. European Commission (May 2020)						
2aa. GDP, price-adjusted	0.6	-6.5	5.9			
2ab. GDP deflator	2.2	2.1	1.6			
2ba. Private consumption, price-adjusted	1.6	-8.3	6.0			
2bb. Private consumption, deflator	1.3	0.3	1.4			
2c. Compensation of employees per head[2)]	3.2	-0.6	3.2			
2d. Total employment	0.9	-0.9	0.6			
2e. Unemployment rate	3.2	4.0	3.5			
3. JEF (April 2020)						
3aa. GDP, price-adjusted	0.6	-4.2	5.8			
3ab. GDP deflator	2.2	1.9	1.3			
4. GCEE (March 2020)						
4aa. GDP, price-adjusted[4)]	0.6	-5.4 to -2.8	1.0 to 3.7			
4ab. GDP deflator	2.2	2.3	2.0			
5. Deutsche Bundesbank (May 2020)[5)]						
5aa. GDP, price-adjusted	0.6	-6.8	3.2	3.7		
5ab. GDP deflator	2.2	2.4	1.2	1.2		
6. IMF (April 2020)						
6aa. GDP, price-adjusted	0.6	-7.0	5.2			
6ab. GDP deflator						
7. OECD (June 2020)[6)]						
7aa. GDP, price-adjusted[4)]	0.6	-6.6	5.8			
7ab. GDP deflator	2.1	1.9	0.8			

1) The projections published in the past three months are reflected in this statement. **– 2)** Values at current prices. **– 3)** International Labour Organization – **4)** The values represent the range of scenarios presented by the GCEE. **– 5)** As the values stated are not calendar-adjusted, they differ from those reported by Deutsche Bundesbank. **– 6)** Values for the scenario without a second wave of the COVID-19 pandemic ("single-hit scenario"). **– 7)** Calendar-adjusted.

b) On the potential output and the output gap

Brief description of the projection by the federal government

The federal government estimates growth in potential output for the year 2020 at 0.8% and for 2021 at 1.1% (cf. Overview 3). By the year 2024, the potential rate is predicted to gradually decline again to 0.8%, essentially attributable to demographic factors. As regards the medium-term outlook a slowdown in potential output growth already occurred in earlier projections. Unlike earlier projections, however, the federal government now estimates the growth rates to be at a lower level in all years. In the current year in particular, at 0.8% the increase is substantially lower compared to the projection of autumn 2019, when the potential rate was estimated at 1.5%. On the whole, therefore, the federal government estimates the price-adjusted potential output to be down by 3.0% in relation to autumn 2019.

Due to the sharp cyclical slump, the output gap will turn out clearly negative in the current year. As the recovery in the coming year will not fully offset the decline, according to the federal government a reduction of the German economy's capacity underutilisation will only occur towards the end of the medium-term projection period. Due to the downward correction of the entire potential output path, the assessment of the degree of utilisation last year was substantially revised upwards. Whereas the output gap in 2019 was still estimated at +0.4% by the federal government in its projection of autumn 2019, it was most recently measured as +1.9%. This correction is essentially based on a reassessment of potential output, whereas GDP largely developed as expected.

Assessment

The fact that the German economy is in a pronounced underutilisation phase this year is undisputed and is in line with the evaluations by other institutions (cf. Overview 3). Quantitative differences can largely be explained by the different forecasts for the decline in price-adjusted GDP. In all estimates of the output gap, the methods to determine the potential output of which are based on the production function approach adopted by the European Commission, an appreciable downward revision of the potential output has been observed and, therefore, an upward revision of the output gap. Whereas from the perspective of Deutsche Bundesbank and the GCEE, the estimate both of the potential rate and of the output gap for 2019 have largely remained unchanged compared to the autumn 2019 projection, the output gap estimated by the JEF and the European Commission has been up by 0.9 and 0.8 percentage points, respectively. The correction implemented by the federal government, up by 1.5 percentage points, is even higher.[3] This immediately results in a changed assessment of the cyclical component of the budget balance in 2019: From today's angle, according to the federal government, cyclical effects have a clearly stronger benefit on public finance (€ 32.7 billion) than had been estimated as recently as half a year ago (€ 6.1 billion).

[3] According to the Federal Ministry for Economic Affairs and Energy, the comparatively sharper correction of the growth path of potential output and, therefore, of the output gap for 2019 is attributable *inter alia* to a more gradual recovery in the phase after the end of the shutdown as of mid-2020 and, therefore, to an economic forecast which differs from those of the Joint Economic Forecast and of the European Commission. The fact that this is retroactive is due to the smoothing process applied in line with the method of the European Commission and therefore is acceptable in the opinion of the Advisory Board.

In addition to the forecast of economic consequences of the corona crisis, the assessment of its long-term potential impacts is fraught with a significant level of uncertainty. Even though the downward revision of potential output carried out by the federal government is rather to be interpreted as a technical outcome of the estimation method used, at least in the medium term, this does not appear to be implausible from an economic point of view. For instance, the disruption of global supply chains and a significant increase in corporate insolvencies might also result in a longer-term impairment of the output prospects of the German economy.

Overview 3: Current estimates of growth of potential output[1)] and of the output gap

Year-on-year percentage change (unless otherwise stated)	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
1. Federal government (April 2020)						
1a. Potential output	1.1	0.8	1.1	0.9	0.9	0.8
1b. Output gap (in % of the potential)	1.9	-5.3	-1.5	-1.1	-0.6	0.0
1bb. Output gap (in € billion)[2)]	64.9	-183.8	-54.0	-39.6	-21.8	0.0
2. European Commission (May 2020)						
2a. Potential output	1.2	0.9	1.2			
2b. Output gap (in % of the potential)	1.0	-6.4	-2.0			
3. JEF (April 2020)						
3a. Potential output	1.2	1.1	1.3	1.2	1.1	1.2
3b. Output gap (in % of the potential)	1.0	-4.3	0.0	0.0	0.0	0.0
3c. Potential output according to MODEM	1.3	1.2	1.1	1.0	0.7	0.6
4. GCEE (March 2020)						
4a. Potential output	1.5	1.4	1.4	1.2	1.2	1.1
4b. Output gap (in % of the potential)[3)]	0.6	-6.3 to -3.6	-5.7 to -1.3			
5. Deutsche Bundesbank (May 2020)						
5a. Potential output	1.4	0.8	0.8	0.8		
5b. Output gap (in % of the potential)[4)]	1.2	-6.6	-4.3	-1.6		
6. IMF (April 2020)[5)]						
6a. Potential output						
6b. Output gap (in % of the potential)						
7. OECD (June 2020)[5)]						
7a. Potential output						
7b. Output gap (in % of the potential)						

1) price-adjusted. **– 2)** In relation to nominal GDP. **– 3)** The values represent the range of scenarios presented by the GCEE**. – 4)** As the values stated are not calendar-adjusted, they differ from those reported by Deutsche Bundesbank. – **5)** Not reported.

5. On the fiscal estimate by the Federal Ministry of Finance

a) On the fiscal estimate (excl. adjustment for temporary and cyclical effects)

Description of the estimate by the Federal Ministry of Finance

The BMF did not submit a consistent fiscal estimate to the Stability Council for the current year and no medium-term estimate, either. These are to be made available only in September once the federal budget for 2021 and the medium-term budgetary plan have been made available.

In its records for the Stability Council for the current year, the BMF merely posts an old calculatory status of April with a general government budget deficit amounting to 7¼% of GDP. This projection corresponds to the Stability Programme of mid-April. The Stability Programme is based on the ad-hoc update of the government forecast on macroeconomic development that served as the basis for the 2020 supplementary budget by the federal government of March. An update to this forecast was not presented. However, the BMF did take account of information concerning measures adopted until end-April for the (sole) purpose of continually updating the structural budget balance. **Based on the BMF information on the structural balance, for the current year the Advisory Board estimates a general government deficit ratio of approx. 8½% of GDP (without taking account of the latest cyclical stimulus package).**

The sharp deterioration in the budget balance reflects the impacts of the COVID-19 pandemic. In addition to corona-related additional expenditure (see below), the automatic stabilisers lead to the economic slump immediately impacting the government budgets: On the one hand, revenue from taxes and social security contributions for employees and employers therefore see a substantial decline, whereas on the spending side, short-time work compensation and unemployment payments in particular see a sharp rise.[4]

Fiscal policy support measures for incomes of private households, for protection of enterprises against insolvencies and for securing employment are additional factors. Since March, various measures have been adopted and taken into account in the calculatory update. The cyclical stimulus package agreed in the coalition committee of the federal government on 3 June was not included. The measures to be taken into account include the expansion in basic security for the unemployed as well as short-time work compensation and unemployment pay. In addition, income shortfalls of parents due to childcare no longer being available are partly compensated. In order to secure jobs, at present the federal employment agency, the Bundesagentur für Arbeit (BA), is refunding the social security contributions for short-time work compensation. Various tax-related measures are intended to ensure that companies

[4] In the case of social security contributions to pension, health and care insurance, the decline in contributions to work remuneration is offset by an increase in contributions to what are known as wage replacement benefits. In the latter case, however, the contribution base only accounts for approx. 80% of the shortfall in planned remuneration, resulting on the whole to negative effects on the revenue side. Moreover, the additional expenditures of the BA in the public-sector budget due to the assumption of contributions to wage replacement benefits are making an impact.

can maintain their internal liquidity and adjust their tax payments speedily to the prevailing poor business situation. For instance, advance payments for taxes on earnings can be lowered and losses netted more simply to a certain extent.[5] In order to support industry segments, it was decided as early as April to lower the rate of value added tax on meals served by restaurants from 19% to the reduced rate of 7% as of 1 July for one year.[6] Moreover, especially individual and small enterprises can obtain transfers to cover their current costs due to corona-related turnover shortfalls. In addition, companies can obtain guarantees for loans and, in certain circumstances, equity capital funding. The latter, however, do not predominantly affect the budget deficit, but the Maastricht debt level (see below).

The government is using additional means of funding to support the public health system. The first issue is to ensure that adequate treatment capacities for COVID-19 cases are available and that the spread of the virus in Germany is permanently contained. In addition, income shortfalls particularly of hospitals or doctors' surgeries are partly compensated if they arise due to the shift of treatment not associated with COVID-19.

The BMF expects the financial situation to deteriorate most severely at federal level. In a year-to-year comparison, the official tax estimate shows that tax receipts are declining more sharply than in the case of federal states and municipalities (federal government: -44½ billion €, federal states: -27½ billion €, municipalities: -12½ billion €). Furthermore – and even more importantly – in the interests of its responsibility for the country as a whole, the federal government is budgeting more resources for corporate aid programmes and will assume the lion's share of financial burdens sustained in the fields of health, the labour market and social affairs. It is noteworthy, however, that the federal states expect greater burdens on their budges than the BMF has noted in its estimate.

The crisis is severely impacting the financial situation of social security funds. At the BA, in the current year it will lead to substantially higher expenditure on short-time work compensation and unemployment pay. This is where the federal government expects a high deficit which, in the assessment of the Advisory Board, is likely to exceed the reserves of the BA. Amongst the other branches, the statutory health insurance fund is particularly severely impacted. However, the burden turns out to be less severe than could be assumed at first sight: in particular, the federal government and partly the federal states are assuming parts of additional expenditure and compensation for discontinued other treatment, providing relief for the insurance funds in question. All social security branches are burdened on the income side by a lower level of contributions received. However, contributions received by statutory health insurance, social care insurance and statutory pension funds are supported by contributions in terms of wage replacement payments by the BA. In the case of health and care insurance, contribution payments for pensioners show a stabilising effect.

Compared to the estimate of last autumn, the budget balance saw a substantial downward revision (cf. Overview 4). The key factors in this regard are economic weakness in the wake of the corona crisis

5 Cf. Advisory Board to the BMF, "Steuerliche Maßnahmen für Unternehmen aus Anlass der Corona-Krise" (Tax measures for companies occasioned by the corona crisis), Berlin 2020.

6 Within the scope of the cyclical stimulus package, on 3 June 2020 the Coalition Committee adopted further temporary relief measures relating to value added tax (see below). As a result, the reduced tax rate (i.e. that charged on meals) will be lowered to 5% in the second half of 2020.

and the associated fiscal support measures. The balance is declining more sharply year-on-year than the revision of the 2020 annual results because the public-sector budgets were already headed in an expansionary direction prior to the crisis: A decline in balances had already been initiated.

Overview 4: Current projections of the budget balance[1)]

In % of GDP	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
1. Calculatory update (May 2020)	1.4	-8½[2)]				
1a. Stability Programme (April 2020)	*1.4*	*-7¼*				
1b. Stability Council (December 2019)	*1½*	*½*	*0*	*0*	*½*	
1c. Draft Budgetary Plan (October 2019)	*1¼*	*¾*	*¼*	*¼*	*½*	
1d. Update (September 2019)	*1¼*	*¾*	*¼*	*¼*	*½*	
1e. Calculatory update (May 2019)	*1*	*¾*	*¼*	*¼*	*½*	
2. European Commission (May 2020)	1.4	-7.0	-1.5			
3. JEF (April 2020)	1.4	-4.7	0.0			
4. GCEE (March 2020)	1.4	-0.8	-1.0			
5. Deutsche Bundesbank (May 2020)	1.4	-6	-3¼	-1¾		
6. IMF (April 2020)	1.4	-5.5	-1.2			
7. OECD (June 2020)[3)]	1.4	-7.1	-3.8			

1) The values for the projection years (2020 for 1., 1a. and 5. and, as of 2019, for 1b. - 1e.) have been rounded to a quarter per cent. **– 2)** Own calculations based on the calculatory update of the structural general government budget balance of the BMF as of 26 May 2020 and the spring projection by the federal government on macroeconomic development of 29 April 2020. **– 3)** Values for the scenario without a second wave of the COVID-19 pandemic ("single-hit scenario").

According to the Stability Programme, in the current year the debt-to-GDP ratio will rise to 75¼% (cf. Overview 5). This means a sharp rise by 15 percentage points in a year-on-year comparison. Apart from the high deficit, a key role is assigned to what are termed "Deficit Debt Adjustments": this means that the growth of debt is higher than explained by the deficit. This is associated in particular with the guarantees for the KfW assistance credit programmes and *Landesförderbanken* (promotional banks owned by the federal states) as well as equity deposits for companies. According to the current assessment by the BMF, these only have a moderate impact on the deficit; the effects on the debt level are considerably higher. As regards the budget balance, governmental guarantees for lending to domestic enterprise are only taken into account once these give rise to payment obligations. Capital deposits are only recorded with an impact on deficit when they compensate losses de facto and are therefore to be considered as transfers. While the balance is hardly impacted at all, this does not apply to the debt level. The new governmental guarantee programmes for (KfW) loans provide for a high level of risk assumption from 80% to 100% of the loan amount.[7] As the governments did instruct the promotional banks with regard to lending and bears the lion's share of default risks itself, when determining the Maastricht debt-to-GDP ratio these are assigned to the state sector and actually increase the Maastricht debt level.

7 The KfW finances the loan amount to an extent of 100% and the loan is then granted by the regular bank. In doing so, the bank assumes no more than 20% of the risk. The loan as a whole (the KfW financing) is assigned to the Maastricht debt level. Up to an extent of € 100 billion, however, this effect on the debt level is covered by the refinancing of the KfW via the economic stabilisation fund of the federal government.

For capital deposits, the BMF generally assumes that these are financed via loans and thus increase the debt level.

However, the data status for calculating the debt-to-GDP ratio only takes account of measures until 27 March. Considering the additional deficit-effective measures already approved, the debt-to-GDP ratio is likely to be even higher, based on the assumptions of the BMF relating to macroeconomic development.

Overview 5: Projection by the Federal Ministry of Finance (Stability Programme, April 2020)[1)]

In % of GDP	2019	2020	2021	2022	2023	2024
1. Budget balance	**1.4**	**-7¼**				
of which:						
1a. Federal government	0.6	-4¾				
1b. State governments	0.4	-1¼				
1c. Local governments	0.2	-¼				
1d. Social security funds	0.3	-¾				
2. Interest expenditure	**0.8**	¾				
3. Primary balance[2)]	**2.3**	**-6½**				
4. Revenue	**46.8**	**47¼**				
of which:						
4a. Taxes	24.2	23½				
4b. Social security contributions	17.4	18¼				
4c. Asset income received	0.6	¾				
4d. Other[3)]	4.5	4¾				
5. Primary expenditure[2)]	**44.6**	**53½**				
of which:						
5a. Social benefits	24.6	27¾				
5aa. of which: non-cash social benefits	8.7	9¾				
5ab. of which: monetary social benefits	15.9	18				
5b. Employee remuneration	7.9	8¾				
5c. Intermediate consumption	5.2	5¾				
5d. Subsidies	0.9	3½				
5e. Gross fixed capital formation	2.5	2¾				
5f. Asset transfers	1.2	1¼				
5g. Other[4)]	2.2	4				
6. Debt-to-GDP ratio	**59.8**	**75¼**				

1) As the calculatory update by the BMF does not provide for a breakdown into individual expenditure and revenue categories, the older projection from the 2020 Stability Programme are used in this table. The differences in relation to the calculatory update predominantly affect tax revenue and social security funds. The values are rounded to a quarter per cent as reported by the BMF for the projection year 2020. – **2)** The primary balance and primary expenditure represent the budget balance or spending to the exclusion of interest expenditure. – **3)** Sales, other current revenue and capital transfers receivable (excluding capital taxes receivable). – **4)** Net receipts of non-produced assets; other current expenditure.

b) On the derivation of the structural general government budget balance

Description of the estimate by the Federal Ministry of Finance

Based on the Stability Programme, the BMF updates the structural general government budget deficit in the current year to 5½% of GDP (cf. Overview 6). In the process, in line with the approach followed in the EU, no one-off and temporary measures are applied (cf. Overview 7).[8] The May tax estimate and the measures adopted until 29 April were taken into account in this update. A fully calculated projection was not submitted. The difference between the unadjusted and the structural budget balance therefore corresponds to the estimated cyclical impact on the level of the balance. The cyclical influence is determined on the basis of the spring projection by the government (see above).

The update by the BMF reflects the contribution of public finances to stabilising the economy in the corona crisis. The change in the primary balance (balance excluding interest expenditure) comprises the change in cyclical and cyclically adjusted (in this case, simultaneously the structural) portion. The former reflects the estimated impact of the automatic stabilisers, and the latter reflects the discretionary fiscal economic support (i.e. the fiscal stance). According to the estimate by the BMF based on the EU method to carry out adjustments for cyclical factors, the automatic stabilisers in the current year will be equivalent to 3¾% of GDP (decline in the cyclical component in relation to GDP compared to the year 2019). The expansionary fiscal stance (change in the cyclically adjusted primary balance ratio) is equivalent to 6 percentage points. It is to be acknowledged that the estimate is particularly difficult at this time; the figures indicated should therefore rather be interpreted as rough in nature.

[8] Cf. European Commission, Vade Mecum on the Stability & Growth Pact, 2019 Edition, Institutional Paper 101, April 2019, p. 9: Principle IV: Deliberate policy actions that increase the deficit do not, as a rule, qualify as one-offs. The provisions on one-offs are primarily meant to avoid policy measures that do not lead to a sustained improvement of the budget balance being treated as structural. In order to give policymakers the right incentive to fully recognise the permanent budgetary impact of their actions, there is therefore a strong presumption that deliberate policy actions that increase the deficit are of a structural nature.

Overview 6: Current projections of the structural budget balance[1)]

In % of GDP or potential output	2019	2020	2021	2022	2023	2024
1. Calculatory update (May 2020)	0.5	-5½				
1a. Stability Programme (April 2020)	*1.3*					
1b. Stability Council (December 2019)	*1¼*	*½*	*¼*	*¼*	*½*	
1c. Draft Budgetary Plan (October 2019)	*1¼*	*½*	*¼*	*¼*	*½*	
1d. Update (September 2019)	*1¼*	*½*	*¼*	*¼*	*½*	
1e. Stability Council (June 2019)	*¾*	*½*	*¼*	*¼*	*½*	
2. European Commission (May 2020)	0.9	-3.8	-0.5			
3a. JEF (April 2020)[3)]	1.0	-2.6	0.0			
3b. JEF (MODEM, April 2020)[3)]	0.7	-2.6	-0.1			
4. GCEE (March 2020)						
5. Deutsche Bundesbank (2020)[2) 3)]	¼	-3¾	-1¾	-1¼		
6. IMF (April 2020)[4)]						
7. OECD (June 2020)[4)]						

1) The values for the projection years (2020 for 1. and 5.and, as of 2019, for 1b. - 1e.) have been rounded to a quarter per cent. **– 2)** The disaggregated approach of Deutsche Bundesbank is used to make adjustments for cyclical effects. **– 3)** To facilitate a better comparison with other estimates, the cyclically adjusted balances are reflected here**.** The JEF and Deutsche Bundesbank consider (unlike the BMF and the European Commission) the predominant share of corona-related measures to be temporary and deduct these from the structural balances. – **4)** Not reported.

Overview 7: Components of the structural budget balance[1)]

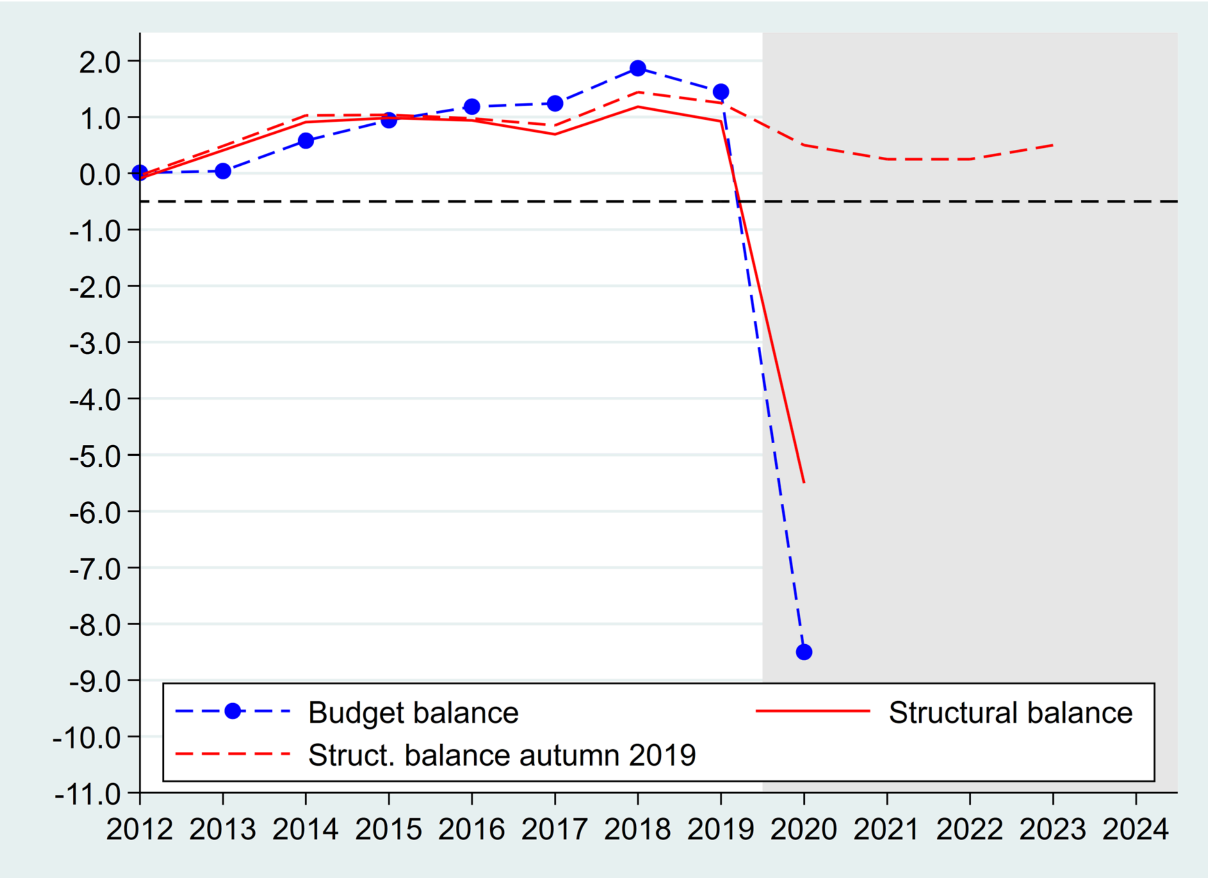
In % of GDP	2019	2020	2021	2022	2023	2024
1. Budget balance	1.4	-8½				
2. Cyclical component	1.0	-2¾	-¾	-½	-¼	0
2.a in € billion[2)]	32.7	-92.6	-27.2	-20.0	-11.0	0.0
3. Cyclically adjusted balance[3)]	0.5	-5½				
4. One-off and temporary measures	0.0	0				
5. Structural budget balance[4)]	0.5	-5½				
6. Cyclically adjusted primary balance[5)]	1.3	-4¾				
7. Output gap	*1.9*	*-5.3*	*-1.5*	*-1.1*	*-0.6*	*0.0*

1) The figures presented are based on the projection of the general government budget balance for the German Stability Programme 2020, the calculatory update for the structural general government budget balance of the BMF of 26 May 2020, the spring projection by the federal government of macroeconomic development of 29 April 2020 as well as calculations by the Advisory Board. The values under 1., 2., 3., 4., 5 and 6. are rounded to a quarter per cent for the projection year 2020. **– 2)** The cyclical component is calculated by multiplying the output gap (in € billion, spring projection 2020) with the budget semi-elasticity for the general government (rounded 0.504). **– 3)** Difference arising from the budget balance and the cyclical component. **– 4)** Cyclically adjusted balance less one-off and temporary measures. – **5)** Cyclically adjusted balance plus interest expenditure in % of GDP.

c) Assessment

The corona crisis currently still is in full swing, even though the restrictions to contain it have already been appreciably eased. At present, the concrete economic impacts can hardly be reliably assessed. For instance, the further course of the pandemic and of the restrictions as well as the macroeconomic and fiscal impacts are highly uncertain. This concerns both the development in Germany itself as well as that of the international economy, which, in turn, reflect back on Germany. Accordingly, each projection made at this time merely represents a snapshot in an environment characterised by a very high level of uncertainty. **Notwithstanding the above, the Advisory Board considers it inadequate that a considerable volume of obsolete and inconsistent data material has been submitted to the Stability Council for the current year. This renders the classification and interpretation a great deal more difficult.**

Fig. 1: Development of budget balance and structural budget balance (excluding the results of the coalition committee of 3 June 2020)



The solid red line reflects the development of the structural budget balance in % of GDP (cf. Overview 6, 1.). The dotted red line reflects the development projected in autumn 2019 of the structural budget balance in % of GDP. The dotted blue line shows the unadjusted budget balance in % of GDP. For the years until 2019, the values reflect the current figures of the European Commission. For the year 2020, with regard to the structural budget balance the current calculatory update by the BMF and for the unadjusted balance an own calculation is displayed, based on this update and on the spring projection by the federal government of macroeconomic development of 29 April 2020.

A general government budget deficit in the order of 8½% of GDP is compatible with the update by the BMF for the structural balance for 2020 (see Overview 6 and Fig. 1)**.** A calculation by the Advisory Board shows this; the BMF did not submit an update on the unadjusted deficit for 2020. **This value is at the upper edge of the comparison spectrum of other institutions**. The fact that other deficit projections partly are considerably lower is likely *inter alia* to their earlier publication dates, at which the negative impact of the corona crisis has not yet been evident to their actual degree. Moreover, the BMF has assumed that loan authorisations will be fully exploited: before the new economic stimulus programme was adopted, in other forecasts these were still predominantly perceived as a safety buffer and were not taken into account in the deficit estimate. Additional measures have meanwhile been adopted, in particular with regard to the economic stimulus package, which are now reflected in the second supplementary budget of the federal government. In the process, the existing reserves are no longer to be resorted to, whereas previously the general (asylum) reserve was still to be reduced by € 10.6 billion. Moreover, about € 30 billion in allocations are being made to extra-budgetary funds, even though a substantial share of the measures to be financed by those transfers will only be implemented in the coming years (e.g. resources to lower the levies under the German Renewable Energy Resources Act (EEG), amounting to € 11 billion).[9]

On the whole, the economic stimulus package will lead to higher deficits compared to the BMF update, especially for the federal government, but also for the federal states. While the package contains domestic loans or transfers to social insurance funds, municipalities and federal states that *per se* will not change the general government budget balance, this will cause a reduction in short-term adjustments needed in the case of social security contributions and, in particular on the spending side for the municipalities. At the same time, the fiscal package is likely to have a positive influence on the business cycle and will therefore be self-sustaining to a certain extent. Deutsche Bundesbank, for instance, estimates that the 2020 deficit quota in its forecast would increase by approximately 1½ percentage points due to the economic stimulus package.[10] However, as the BMF update already assumed the utilisation of existing budgetary buffers and as the second supplementary budget of the federal government includes extensive provisions for the coming budgetary years with a substantial boost in net borrowing by € 62.5 billion, **the deficit ratio derived by the Advisory Board of 8½% for the current year is therefore likely to need less severe adjustments. However, maintaining the macroeconomic assumptions, the deficit could nevertheless exceed 9% of GDP.**

The structural budget deficit in the current year is assessed by the BMF at 5½% of GDP and will thus turn out to be considerably higher than 0.5% of GDP. The derivation of the structural budget balance in the BMF projection is essentially based on the cyclical adjustment method used by the European Commission. The estimate of the cyclical component of the budget balance is extremely difficult during crisis times: the high degree of uncertainty concerns the expected economic development as well as its breakdown into a cyclical and a structural part. The relatively large differences between the revised

[9] Excluding the equity share in Deutsche Bahn (German Rail). The extra-budgetary funds taken into account are: “Kinderbetreuungsausbau” (Extension of childcare), amounting to € 1 billion, “Ausbau ganztägiger Bildungs- und Betreuungsangebote für Kinder im Grundschulalter” (Extension of full-day educational and care offerings for children at primary school age), amounting to € 1.5 billion, “Energie- und Klimafonds” (Energy and Climate Fund), amounting to € 26.2 billion, and “Digitale Infrastruktur” (Digital Infrastructure), amounting to € 1 billion.

[10] Cf. for an initial classification: Deutsche Bundesbank, Outlook for the German economy for 2020 to 2022, Monthly Report June 2020.

estimates by the European Commission and the federal government for the 2019 output gap appear to be acceptable to the Advisory Board against the backdrop of the generally high dispersion of output gap estimates and high estimation uncertainty, even though this leads to the cyclical component of the budget balance of the year 2019 being estimated at the highest level compared to other projections. **However, all in all a structural deficit of 5½% in the year 2020 appears to be compatible with the fiscal and macroeconomic projection by the BMF.** Taking account of the economic stimulus package agreed on 3 June, the structural budget deficit will turn out appreciably higher. As a great deal of the package is temporary in nature, this additional burden would see a corresponding decline again in the further course of time.

In the EU budget monitoring methods used to determine the structural budget balance, as a rule the deficit-increasing measures associated with the COVID-19 pandemic were not counted as temporary items. This may have a critical effect in the future. It would need to be ensured that once the crisis has been overcome, the adjustment paths to the regular budget targets are not excessively protracted. This danger exists if the expiry of temporary corona measures improves the structural budget balance and if this is evaluated as a consolidation as contemplated by the European provisions: as a rule, these provide for an annual improvement in the structural budget balance by 0.5% of GDP, and the temporary burdens mostly are considerably higher. In this case, any fundamental difficulties would possibly only be corrected very slowly.

6. Exceeding the upper limit for the general government budget deficit

According to the resolution proposal of 4 May, the Stability Council assumes that the regular upper limit for the structural general government budget deficit amounting to 0.5% of GDP will be significantly exceeded in the year 2020. However, the deviation is assessed as permissible pursuant to Section 51 (2) sentence 2 HGrG. This regulation refers to the European provisions with regard to the possible deviation from the upper limit. According to Article 3 (1) letter c) of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union of 2 March 2012 (European Fiscal Compact), a deviation is possible in extraordinary circumstances. Article 3 (3) letter b) of the same treaty thus addresses an exceptional event that is beyond the control of the government and has considerable consequences as far as public finances are concerned.[11]

The classification of the current situation as exceptional as contemplated by the European Fiscal Compact corresponds to the recommendation by the European Commission of 20 March 2020 and the statement by the European economy and finance ministers (ECOFIN Council) of 23 March. The decision to assess the current situation as exceptional as contemplated by Article 115 (2) sentence 6 of the German constitution was also shared by the Bundestag in its resolution of 25 March.

The Advisory Board likewise assesses the present conditions to be extraordinary and to have reached crisis proportions and therefore considers recourse to the escape clauses of the fiscal rules to be correct. Compliance with the upper limit for the structural budget deficit is not necessary for the time being. Accordingly, no measures need to be taken at present to lower the deficit.

Even though no obligation to comply with the above-mentioned upper limit exists at present, this does not provide a blanket justification for credit-funded expenditure or tax cuts to any extent. The purpose of the escape clause in the European and national body of rules for debt containment consists in guaranteeing the ability of the state to take specific action to overcome a crisis. According to national law, the federal government and the federal states (but not social security funds and municipalities) are authorised to engage in supplementary borrowing to the extent necessary to which the expenses of dealing with and overcoming the emergency situation in terms of health and economic aspects are in line with the relevant competences, certain, suitable and necessary. Whereas there is some political leeway as regards the extent necessary, expenditure due to the emergency situation may not be arranged simply because the opportunity exists right now, and this must not be done “ultra vires”, i.e. beyond the executives’ own competences, either.[12]

In view of the current crisis, the Advisory Board considers the extent of the deficit-effective measures adopted thus far to be acceptable. Since the need to combat the pandemic by imposing contact bans and restrictions on business activities severely impairs economic development in any case,

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[11] Article 3 (3) b states: “exceptional circumstances” refers to the case of an unusual event outside the control of the Contracting Party concerned which has a major impact on the financial position of the general government or to periods of severe economic downturn as set out in the revised Stability and Growth Pact, provided the temporary deviation of the Contracting Party concerned does not endanger fiscal sustainability in the medium-term.

[12] Cf. Hans-Günter Henneke, “Coronabedingte Finanzschäden in den (Kommunal-)Haushalten isolieren” (Isolating corona-related financial losses in (municipal) budgets), *Deutsches Verwaltungsblatt* 11 (2020), 725 (727 ff.) m.w.N.

it makes sense to ensure that the measures are currently financed not by expenditure cuts or tax increases, but by expanding the level of debt instead. However, financing contributions could be achieved by means of budgetary write-backs of existing reserves, such as the general (asylum) reserve of the federal government. This is likely to be required under budgetary law. Indeed, the draft of the second supplementary budget of the federal government dispenses with the need for the withdrawal planned within the scope of the first supplementary budget of € 10.6 billion from the general (asylum) reserve. The total volume of that reserve had been quantified with € 48.2 billion in March. Moreover, the second supplementary budget provides for significant resources for the pre-financing of extra-budgetary funds. However, the general government budget balance and, largely, the Maastricht debt level will not be changed if net borrowing is extended instead of utilising existing reserves or if extra-budgetary funds are pre-financed rather than funding the relevant expenditure as the payment outflows unfold.

From the Advisory Board's perspective, at present the primary focus is rightly on economic support. It is important to protect the economic foundations for growth during the crisis. This includes securing employment and income prospects as well as a good outlook for corporate investments. After all, solid economic development facilitates solid public finances. With regard to the appropriateness of the measures, however, their consequential burdens need to be borne in mind. Credit funding will be substantially extended already due to the measures adopted by end-May, and appreciable further strains are likewise on the horizon. For instance, on 3 June the coalition committee of the federal government adopted a further package of measures that calls for a further supplementary budget. Additional supplementary budgets are planned by the federal states. Moreover, extensive measures are in preparation at European level that are likely to call for significantly higher financing contributions to be made by Germany. Accordingly, within a very short space of time, very extensive measures have already been initiated that, in terms of their general orientation and volume, will facilitate a stabilisation. As a sluggish recovery is not unlikely against the backdrop of the global impacts of the pandemic, in future additional measures might be necessary, especially since a further wave of infections cannot be ruled out at this time. **Against this backdrop, the Advisory Board considers it sensible, in the context of possible additional measures to stabilise the economy, for fiscal policymakers to initially wait and see how the pandemic unfolds and to assess to what extent the past measures taken have been effective.**

Even though the currently massive deployment of credit financing is justified, it must be reduced in the further course of time. This does not mean that when taking decisions on the execution of measures to stabilise the economy, consolidation measures should be contemplated at the same time;[13] consolidation measures necessary at a later stage should not be completely ignored either. The provisions under constitutional law regarding the debt brake require **"repayment of the loans taken out within an appropriate period"**, underpinned by a concrete repayment schedule. This means that the burdensome impact for the future is recognised as such; at the same time, however, a sensible repayment schedule in line with the economic conditions prevailing from time to time is facilitated, allowing for the repayment schedule to be retroactively curtailed or extended, as the case may be.

[13] Deutsche Bundesbank, Monthly Report May 2020, p. 76.

The statutory provisions for the Stability Council require compliance with the agreed upper limit for the structural budget deficit at European level to be assessed not only for the current year, but for the four subsequent years thereafter as well. Still, no evaluation is in hand at present for the years 2021 to 2024. The resolution proposal refers to an inadequate data status. Being an economic consultancy body, the Advisory Board does not provide a legal assessment as to whether this can be viewed as justified against the backdrop of the legislative situation. However, in view of the very high level of uncertainty, the Advisory Board considers it acceptable to dispense with the need for a medium-term projection at this time and not to give any medium-term recommendations for action with regard to future compliance with the upper limit by now.

Moreover, an assessment of compliance with the relevant rules in the further course of time already appears not to be possible *de facto* because the requirements depend on when the European general escape clause will be suspended again.[14] On the whole, it is to be expected that the very high deficits in the current year will decline again in the course of time, alone because first of all the macroeconomic recovery will set in and secondly because the temporary fiscal support measures will expire. That the regular upper limit will automatically be reached again appears questionable at this time – although not impossible. In view of the favourable level of interest rates, the higher debt will not constitute an additional burden initially. As regards the fiscal challenges involved, it will depend to a decisive degree on what growth path of potential output the economy will follow and to what extent structural growth shortfalls will be registered in this context.

The Stability Council should clarify that the current deviation from the upper limit for the structural general government budget deficit will be corrected in accordance with European provisions as soon as the exceptional situation no longer exists. A corresponding explanation by the Stability Council would make a key contribution towards alleviating concerns of a destabilisation of public finances.

7. Additional touchstones for sustainability of public finances

Although – due to the exceptional circumstances at present – the upper limit for the general government budget balance does not have to be complied with and a substantial expansion in credit financing is called for, fiscal policy must keep an eye on the aim of sustainability of public finances. A number of aspects must be borne in mind in this context.

- In future verification of compliance with the rules by the Stability Council, an eye must be kept on the level of **interaction between European and national rules**. Differences do exist in this regard. For instance, on the basis of the European rules a longer adjustment path to the regular limits for the structural deficit may turn out to be necessary than on the basis of the national rules. The European rules provide for a minimum improvement of the structural deficit at a debt-to-GDP ratio above 60%. In contrast, the national rules – after the end of the exceptional situation – provide for compliance with the regular limits and a repayment schedule for extraordinary borrowing.

[14] The European budgetary rules provide wide discretionary scope in this regard, cf. Deutsche Bundesbank, loc. cit.

- The national rules are more flexible in comparison with the European rules when it comes to utilisation of existing reserves. Moreover, evidently the partly deviating delineations – such as the public sector – are being used for additional flexibility when it comes to the debt brake. In addition, numerous states do not use the European methods for cyclical adjustment. The effort for the Stability Council is correspondingly higher to verify after expiry of the escape clauses whether the European and the national provisions are duly being taken into account. Where necessary, any differences in this regard would need to be explained and the risks addressed relating to compliance with the rules in question. **The Advisory Board points out that not least on account of the described heterogeneity at the level of the federal states and due to the differences between national and European requirements, outstanding importance is assigned to data provision and processing, a task that is not adequately addressed at this time.** Accordingly, the Advisory Board considers a substantial improvement in the data status necessary.[15] The crisis and the presumed subsequent challenges should be perceived – not least with regard to internal policy coordination – as an opportunity to achieve an improvement in this regard.
- As mentioned, the **national rules stipulate a concrete repayment schedule for exceptional borrowing during the crisis, with the choice of the repayment period being dealt with differently.** For the federal government and the majority of federal states, the rules provide for emergency loans to be repaid within a reasonable period of time. Other countries have specific provisions, still others ultimately only prescribe a repayment schedule without any specific details of its framework conditions. The differences in the rules in question are reflected in current practice. The repayment period provided for by the federal government in the supplementary budget of March extends to 20 years. The federal states have selected quite different repayment periods. The median repayment period is 10 years.[16] North-Rhine-Westphalia, a state that already had an above-average debt level before the crisis emerged, opted for the longest repayment period. A period of 50 years has been specified here. Accordingly, the subsequent burdens are to be repaid over a very long period. The Advisory Board notes that very long repayment periods can endanger the need to secure the long-term sustainability of public-sector budgets and future compliance with debt limits, especially when above-average indebtedness already existed at the outset.
- Both the measures adopted at federal level as well as the packages of measures taken by the federal states provide for a **substantial expansion of the guarantee framework**. In terms of the supplementary budget of the federal government, the maximum permissible guarantees assumed were increased by € 357 billion. Moreover, there is an option of a surcharge increased by 10 percentage points to 30% on the entire volume (additional expansion by € 153 billion). Financing commitments equivalent to € 400 billion are also available for the Economic Stabilisation Fund. The concrete utilisation of these authorisations cannot be reliably estimated at this time. While the supplementary budget of the federal government of March 2020 provides for funding to cover larger-scale defaults, on the whole it is not considered unlikely that the defaults will exceed this particular limit. An expansion in possible guarantee assumptions has likewise been adopted at federal state level. For the 11 federal states with corresponding resolutions, the general limit (status as of early June) will expand by € 68 billion.

[15] In this context, cf. 11th Statement by the Independent Advisory Board of the Stability Council, Berlin, 2019.
[16] Information is currently available for all federal states except for Saarland and Thuringia.

- The **municipalities are** subject to relatively tight budgetary rules. Unless extensive reserves exist, the currently severe shortfalls in revenue cannot simply be absorbed, especially since additional spending has been projected. **In order to avoid a sharp, short-term consolidation (e.g. via investments) or an alarming flight into cash loans, financial support will be necessary.** The federal government's draft of the second supplementary budget provides for shortfalls in the local business tax to be compensated to an extent of € 6 billion. In addition, the participation by the federal government in municipal accommodation costs for persons drawing basic security benefits is to be permanently increased by about € 3½ billion p.a., taking account of the self-administration tasks involved. Moreover, a non-recurring increase in regionalisation resources by € 2½ billion is planned by the federal government, evidently to compensate remuneration shortfalls in the public commuter transport system (ÖPNV). Furthermore, the Advisory Board assumes that the shortfalls occasioned by the planned reduction in value added tax rates will be compensated. Moreover, from the Advisory Board's perspective it would need to be established in the further course of time how to deal with additional future burdens in connection with tax-dependent allocations to federal states in the coming year. In contrast, the need to deal with what is known as the legacy debt problem in a low interest rate phase neither has anything to do with the current corona crisis, nor does it fall within the responsibility of the federal government. Individual federal states have already taken key steps in this regard. In order to avoid high cash loans in municipal financing in the future, it appears to be sensible in the opinion of the Advisory Board to fundamentally reform municipal funding as a whole and to place it on a less volatile footing.
- The Advisory Board considers an extensive stabilisation of the economy via public finances correct in principle. At the same time, the Advisory Board points out that future challenges to public finances must not be allowed to be ignored. **It will thus need to be established in the further course of time how to deal with looming substantial increases in contributions to social security funds in the wake of demographic development**. The impacts of the corona crisis exacerbate existing problems, and the financial situation of social security funds is additionally compounded. According to the resolution adopted by the coalition committee on 3 June 2020, social security contributions are to be stabilised at a maximum of 40 per cent. Financial needs of social security funds exceeding that percentage are to be financed "at least until the year 2021" from the federal government budget and, therefore via additional borrowing and future tax revenue. In the statutory pension system, a considerable contribution rate increase and a sharp rise in federal subsidies are likely to arise.[17] At present, the plans for a basic pension ("Grundrente") results in a structural expansion of expenditure, the funding of which hitherto remained unresolved in terms of the federal budget. There is a need for possible solutions as to how the foreseeable problems are to be resolved. This was emphasized most recently by the Advisory Board to the BMF.[18]
- **At EU level, extensive debt-financed measures are under discussion at present.** Statistically, borrowing under the EU budget, for instance, will probably not have an impact on the national budgets. At the end of the day, however, the debts will need to be repaid by the same group of taxpayers – even though the concrete distribution to the member states has not yet been finally

[17] According to the statutory rules, the increase in the contribution rate automatically causes the general federal subsidy to rise, but this does not apply to the federal government's share of receipts from statutory pension insurance. However, until 2025 the stop line of 20 per cent will apply to the contribution rate and to the contribution rate guarantee of the federal government.

[18] Cf. Advisory Board to the BMF, "Der schwierige Weg zu nachhaltigen Reformen" (The difficult path to sustainable reforms), Berlin 2020.

settled. The European Commission has proposed borrowing € 750 billion (in addition to the Sure Programme already adopted) to finance the EU budget. Of this sum, € 500 billion is to be utilised for transfers. This would give rise for the first time to a (national accounts) deficit at EU level: unlike the situation when borrowing in order to facilitate lending, in the case of transfers the new debt is not associated with financial assets (such as loan receivables). This means that the member states would need to make higher contributions in future in order to pay interest on debt assumed at EU level and to continue paying such debt. Measured based on its GDP share, Germany would be assigned approx. € 125 billion of the € 500 billon in EU debt. The European Commission proposes postponing the repayment far ahead into the future. It is to begin only in the year 2028 and to continue until the year 2058. The design and extent of any transfers ultimately is a political decision. Engaging in extensive borrowing at EU level entails considerable risks, however. Care would need to be taken to ensure that future burdens will be transparently reflected; after all, a corresponding volume of funding will be required in the further course of time. Without this transparency, there is a danger of a debt illusion that would further undermine the existing fiscal rules.

The Independent Advisory Board of the Stability Council on 18 June 2020

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