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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 (DBP) for 2019 on 15 October 2018 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 (MTO). As the debt ratio was 63.9% of GDP in 2017, Germany also needs to comply with the debt reduction benchmark.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2018 autumn forecast. Section 3 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 2018 autumn forecast. In particular, it includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2018-2019 (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 2018, 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

The macroeconomic scenario underlying the DBP projects the German economy to continue its expansionary phase in 2018 and 2019, supported by domestic demand. The global economy is expected to lose momentum in the projection period, reflecting increased uncertainty and protectionist tendencies. Relatively moderate growth is therefore expected for exports, while imports are forecast to grow more markedly due to ongoing strong domestic demand. Foreign trade is therefore expected to make a slightly negative contribution to growth, which is the main revision compared to the projections included in the 2018 Stability Programme. On the domestic side, investment in machinery and equipment are projected to continue at a robust pace, in view of high capacity utilisation. Construction investment is expected to remain brisk due to low interest rates and high demand, including from the public sector. The labour market is projected to continue showing positive developments, with employment set to rise and a further fall in unemployment expected in 2019. At the same time, household incomes are forecast to increase noticeably, reflecting rising wages and fiscal relief, thus underpinning a dynamic consumer demand.

Table 1. Comparison of macroeconomic developments and forecasts

	2017	2018			2019		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	2.2	2.4	1.8	1.7	1.9	1.8	1.8
Private consumption (% change)	1.8	1.9	1.6	1.6	1.7	2.0	2.1
Gross fixed capital formation (% change)	2.9	3.8	3.0	3.1	3.2	2.7	2.9
Exports of goods and services (% change)	4.6	5.3	2.8	2.8	4.0	3.7	2.9
Imports of goods and services (% change)	4.8	5.8	3.6	3.3	4.8	4.9	4.2
Contributions to real GDP growth:							
- Final domestic demand	1.8	2.2	1.8	1.7	1.9	2.1	2.1
- Change in inventories	0.0	0.0	0.1	0.0	0.0	0.0	0.0
- Net exports	0.3	0.2	-0.1	0.0	0.0	-0.2	-0.3
Output gap[1]	0.8	0.6	0.7	0.6	0.7	0.4	0.4
Employment (% change)	1.4	1.1	1.3	1.3	0.8	0.9	0.8
Unemployment rate (%)[2]	3.8	3.2	3.2	3.5	3.0	2.9	3.2
Labour productivity (% change)	0.7	1.2	0.4	0.4	1.0	0.9	1.0
HICP inflation (%)	1.7			1.8			1.9
GDP deflator (% change)	1.5	1.8	1.7	1.8	1.9	2.0	2.0
Comp. of employees (per head, % change)	2.6	2.7	2.9	2.9	3.0	3.1	3.0
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	8.0	7.9	7.5	7.6	7.7	7.4	7.3

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.

[2]The unemployment rate contained in SP and DBP columns follows the ILO-definition.

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

The macroeconomic scenario underlying the DBP is plausible and broadly in line with the Commission 2018 autumn forecast. It is more optimistic regarding the evolution of exports, although explicit about increased uncertainty and risks. The Commission forecast assumes that some of these risks materialise and therefore factors in a stronger negative impact on foreign trade.

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 2019 DBP on 16 October 2018 in a statement published on its website (gemeinschaftsdiagnose.de).

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

As usual the DBP reports on the budgetary situation of the general government, which comprises the federal government, regional governments, municipalities and social security funds. The DBP projects a general government headline budget surplus of 1½% of GDP for 2018 and 1% of GDP in 2019. Compared to the 2018 Stability Programme this projection is higher for 2018 (previously 1% of GDP) and lower for 2019 (previously 1¼% of GDP).[1] The difference is mainly due to better-than-expected tax revenues in 2018 and the incorporation of the government measures of the March 2018 coalition agreement that were still under preparation at the time of the 2018 Stability Programme. Total revenue is higher by about ½% of GDP due to the good situation of tax revenues. Total expenditure is planned to be larger by about ¾% of GDP due to higher social payments and investment, as agreed in the coalition agreement.

In contrast to the 2018 Stability Programme, which projected an increase of the (recalculated) structural balance[2] from 0.7% of GDP in 2018 to 0.9% in 2019, the DBP forecasts a decrease of the (recalculated) structural balance from 1.3% of GDP in 2018 to 0.7% in 2019.

The DBP's fiscal projections for 2018 are broadly in line with the Commission 2018 autumn forecast, which expects a headline surplus of 1.6% of GDP and a structural surplus of 1.4% of GDP. Similarly, the DBP fiscal projections for 2019 are close to the Commission forecast, which projects a headline surplus of 1.2% of GDP and a structural surplus of 1.0% of GDP, based on a no-policy-change assumption. The differences in 2019 can be explained by slightly lower expectations of the Commission 2018 autumn forecast as regards the increase in overall government expenditure for social payments and subsidies.

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

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

Table 2. Composition of the budgetary adjustment

(% of GDP)	2017	2018			2019			Change: 2017-2019
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**45.0**	**44 ¾**	**45½**	**45.3**	**44 ¾**	**45¼**	**45.1**	¼
of which:								
- Taxes on production and imports	10.5	10 ½	10½	10.5	10 ½	10½	10.4	0
- Current taxes on income, wealth, etc.	12.9	13	13¼	13.1	13	13¼	13.1	¼
- Capital taxes	0.2	0	0	0.2	0	0	0.2	-¼
- Social contributions	16.7	16 ¾	16¾	16.9	16 ¾	16¾	16.8	0
- Other (residual)	4.7	4 ¾	5	4.6	4 ½	4 ¾	4.7	0
Expenditure	**43.9**	**44**	**43¾**	**43.8**	**43 ½**	**44¼**	**43.9**	¼
of which:								
- Primary expenditure	42.9	43	43	42.8	42 ½	43 ½	43.1	½
of which:								
Compensation of employees	7.5	7 ½	7½	7.5	7 ½	7½	7.5	0
Intermediate consumption	4.8	4 ¾	4¾	4.7	4 ¾	4¾	4.8	0
Social payments	23.9	23 ¾	24	23.8	23 ¾	24¼	24.1	¼
Subsidies	0.9	1	¾	0.8	1	1	0.8	0
Gross fixed capital formation	2.2	2 ¼	2¼	2.4	2 ¼	2½	2.4	¼
Other (residual)	3.6	3 ½	3 ½	3.6	3 ½	3 ½	3.4	0
- Interest expenditure	1.0	1	1	0.9	1	¾	0.9	-¼
General government balance (GGB)	**1.0**	**1**	**1½**	**1.6**	**1 ¼**	**1**	**1.2**	**0**
Primary balance	**2.1**	**2**	**2½**	**2.5**	**2 ¼**	**1¾**	**2.0**	**-¼**
One-off and other temporary measures	-0.2	-¼	0	-0.2	0	0	0.0	¼
GGB excl. one-offs	**1.3**	**1**	**1½**	**1.8**	**1 ¼**	**1**	**1.2**	**-¼**
Output gap[1]	0.8	0.6	0.7	0.6	0.7	0.4	0.4	-0.6
Cyclically-adjusted balance[1]	0.6	0.6	1.2	1.2	0.9	0.7	1.0	0.2
Structural balance (SB)[2]	**0.8**	**0.7**	**1.3**	**1.4**	**0.9**	**0.7**	**1.0**	**0.0**
Structural primary balance[2]	1.8	1.8	2.2	2.4	1.9	1.6	1.8	-0.2

Notes:

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

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

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Germany currently standing at 0.44%[3]. As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the DBP, interest expenditure in Germany is expected to fall from 1% of GDP in 2018 to ¾% of GDP in 2019. The picture stemming from Germany's DBP is broadly confirmed by the Commission forecast.

Against the background of falling interest expenditure, the projected development of the structural balance (+0.5% in 2018 and -0.6% of GDP in 2019) is accompanied by a slightly less pronounced improvement in the structural primary balance (+0.4% and -0.6% of GDP, respectively).

Based on the DBP, 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.[4] At its 17th meeting on 18 June 2018 the Fiscal Council (Stabilitätsrat) concluded that the federal government adhered to the national fiscal rules in the year 2017 and was expected to do so in 2018 and 2019.[5]

3.2. Debt developments

The debt-to-GDP ratio decreased by 4.0% of GDP to 63.9% in 2017. The DBP projects the debt-to-GDP ratio to decline further to 61% of GDP in 2018 and 58% in 2019, owing to the budget surplus and the positive denominator effect of nominal GDP growth. The debt projections are similar to those of the 2018 Stability Programme. In addition, they come very close to the Commission 2018 autumn forecast, which, however, projects a slightly stronger decline of the debt ratio in 2018 and 2019.

[3] 10-year bond yields average as of September 2018. Source: Bloomberg.

[4] The constitutional 'debt brake' provides that as of 2016 the structural balance of the federal budget must not exceed a deficit of 0.35% of GDP, with a gradually decreasing ceiling along an agreed transition path in the preceding years. The federal states must have structurally balanced budgets as of 2020.

[5] For the national stability report see: http://www.stabilitaetsrat.de/SharedDocs/Downloads/DE/keine_Dokumentensuche/Parlamentsdokumente/20180626/20180626_TOP1.pdf?__blob=publicationFile

Table 3. Debt developments

(% of GDP)	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**63.9**	**61**	**61**	**60.1**	**58 ¼**	**58**	**56.7**
Change in the ratio	-4.0	-2 ¾	-2 ¾	-3.7	-2 ¾	-3	-3.4
Contributions[2] :							
1. Primary balance	**-2.1**	**-2**	**-2 ½**	**-2.5**	**-2 ¼**	**-1 ¾**	**-2.0**
2. "Snow-ball" effect	**-1.4**	**-1 ½**	**-1 ¼**	**-1.2**	**-1**	**-1 ¼**	**-1.4**
Of which:							
Interest expenditure	1.0	1	1	0.9	1	¾	0.9
Growth effect	-1.4	-1.4	-1.1	-1.1	-1.1	-1.1	-1.1
Inflation effect	-1.0	-1.1	-1.1	-1.1	-1.1	-1.2	-1.2
3. Stock-flow adjustment	**-0.5**	½	**1**	**0.0**	¾	¼	**0.0**

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 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the draft budgetary plan

In 2018 the government's fiscal stance is contractionary, with the structural surplus improving considerably due to better-than-expected tax revenue but also to the delayed implementation of policy measures following the lengthy process of forming a government. In 2019 many of the already adopted government measures of the March 2018 coalition agreement show their effect and the fiscal stance becomes noticeably expansionary. The surplus-decreasing negative fiscal impact of those measures is projected at 0.1% of GDP in 2018 and at 0.7% of GDP in 2019. Those measures aim to strengthen investment in the areas of education, research, universities and digital technologies. Families and children are supported by better childcare facilities and social benefits and tax reliefs. Increased investment grants targeting agriculture, transport, rural regions and local authorities are set to support equitable living conditions throughout the country.

All those measures together are estimated to have a cumulative negative fiscal impact, totalling 2.2% of GDP over the period 2018 to 2022, covered in the current 5 year financial plan adopted by the federal government. Together with further planned but not yet adopted measures to reduce the contribution rate to the unemployment insurance, further increases in the basic subsistence allowance and the return to the equal funding of health care costs by employers and employees as well as contribution reductions for self-employed, the overall cumulative negative fiscal impact is expected to attain 4.0% of GDP over the period 2018 to 2022.

The following table summarises only newly included measures since the updated DBP from June 2018.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% of GDP) (as reported by the authorities)	
	2018	**2019**
Taxes on production and imports	0.0	0.0
Current taxes on income, wealth, etc.	0.0	-0.1
Capital taxes		
Social contributions	0.0	0.0
Property Income		
Other		
Total	0.0	-0.2

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.
Source: Draft Budgetary Plan for 2019

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% of GDP) (as reported by the authorities)	
	2018	**2019**
Compensation of employees		
Intermediate consumption		
Social payments		
Interest Expenditure		
Subsidies		
Gross fixed capital formation		
Capital transfers		
Other		0.0
Total	0.0	0.0

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.
Source: Draft Budgetary Plan for 2019

With regard to the fiscal-structural elements of the Recommendations of 13 July 2018[6] addressed by the Council to Germany to, while respecting the medium-term budgetary objective, use fiscal and structural policies to achieve a sustained upward trend in public and private investment, and in particular on education, research and innovation at all levels of government, in particular at regional and municipal levels, the DBP shows increasing investment expenditure for digital and transport infrastructure as well as additional funds for education, research and universities. Those measures are expected to be beneficial for supporting potential growth and 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 DBP, public investment is expected to increase from 2¼% of GDP in 2018 to 2½% of GDP in 2019. This compares to an average of 2¾% of GDP in 2017 in the rest of the euro area without Germany. Further efforts are thus needed to increase public investment in a sustained manner and clear the investment backlog, especially at municipal level. Due to limited capacities in the construction sector however, some of the beneficial effects of additional public investment spending may be partly eroded by a substantial price effect. With the planned stable development of revenues and expenditures, the positive balance of public finances would allow for those measures to be financed.

[6] Council Recommendation of 13 July 2018 on the 2018 National Reform Programme of Germany and delivering a Council opinion on the 2018 Stability Programme of Germany, OJ C 320, 10.9.2018, p 19-23.

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

Germany is subject to the preventive arm of the Stability and Growth Pact and the debt reduction benchmark.

4.1. Compliance with the debt criterion

As the debt ratio was 63.9% of GDP in 2017, Germany needs to comply with the debt reduction benchmark. The information provided in the DBP points to compliance with the debt reduction benchmark in 2018. In 2019, Germany is projected to achieve a debt-to-GDP-ratio below the 60% Treaty reference value, implying compliance with the provisions of the Stability and Growth Pact with regard to the debt criterion. This is in line with the Commission 2018 autumn forecast.

Table 5. Compliance with the debt criterion

	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	63.9	61	61	60.1	58 ¼	58	56.7
Gap to the debt benchmark [1,2]	-6.7	-5.8		-6.6	n.r.	n.r.	n.r.

Notes:

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

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

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

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

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

4.2. Compliance with the MTO

Germany registered a structural surplus of 0.8% of GDP in 2017, well above its medium-term objective of a structural deficit not exceeding 0.5% of GDP. According to the information provided in the DBP in 2018 and 2019, Germany is expected to remain well above its MTO with a (recalculated) structural surplus of 1.3% and 0.7% of GDP respectively, which is confirmed by the Commission 2018 autumn forecast.

The projected margin to the MTO continues to provide scope to undertake additional expenditure for achieving a sustained upward trend in public and private investment, and in particular on education, research and innovation at all levels of government, in particular at regional and municipal levels, as recommended by the Council in the context of the European Semester.

Table 6. Compliance with the requirements of the preventive arm

(% of GDP)	2017	2018		2019	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	0.8	1.4		1.0	
Structural balance based on freezing (COM)	0.9	1.4		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2017**	**2018**		**2019**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	Compliant				
Required adjustment corrected[5]					
Change in structural balance[6]					
One-year deviation from the required adjustment[7]					
Two-year average deviation from the required adjustment[7]					
Expenditure benchmark pillar					
Applicable reference rate[8]					
One-year deviation adjusted for one-offs[9]					
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 (p.p.) is allowed in order to be evaluated as having reached the MTO.

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

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

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

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

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 20XX-1) was carried out on the basis of Commission 20XX 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 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations.

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

The DBP projects higher revenues and similar expenditures for 2018 at 45½% and 43¾% of GDP respectivley compared to 2017 at 45.0% and 43.9% respectively. The higher revenues are mainly due to better-than-expected taxes on income and wealth, whereas the longer than usual process of forming a government until March 2018 led to subdued government spending. For 2019 the DBP projects slightly lower revenues at 45¼% and based on measures of the coalition agreement higher expenditure at 44¼%. The structural balance thus is projected to improve considerably in 2018 by 0.5% of GDP, before declining again in 2019 by 0.6% of GDP.

Public investment is planned to accelerate to 2½% of GDP in 2019, slightly higher than in 2018 at 2¼% of GDP, which is also the long-term average of the past years.

The DBP includes measures taken in response to the country-specific recommendations issued in the broader area of public finances. The launching of the fund for Digital Infrastructure is targeted to provide a very high-capacity broadband infrastructure nationwide. Measures to improve childcare facilities as well as support for education and training follow the recommendation for stronger public investment in education and research and innnovation. 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 taxation system is in general complex and could be simplified and improved to support investment and the business environment. Earlier measures to modernise taxation procedures by strengthening electronic communication and measures to combat tax avoidance and aggressive tax planning are ongoing.

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 securtiy contributions for low paid jobs and self-employed will benefit above all low- and middle-income earners (see Box 2).

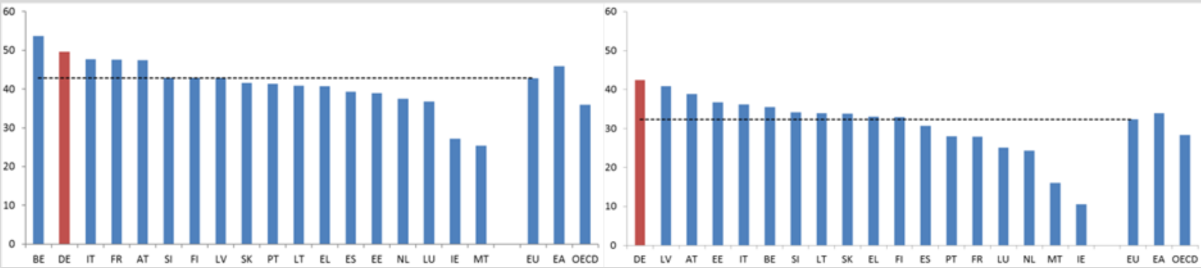
Public sector wages are expected to grow by 2.6% in 2018 and 3.0% in 2019 based on the Commission 2018 autumn forecast, relating to the Recommendation of 13 July 2018 addressed by the Council to Germany to create conditions to promote higher wage growth, respecting the role of social partners.

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 that 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 those 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 (2017)



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

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

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

In the context of the 2018 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 by increasing the basic personal tax-free allowance, the child benefit and tax-free child allowance as well as by offsetting 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, supports the lowering of the tax wedge from the side of social security contributions. Overall, those measures are expected to positively contribute to growth and employment.

6. OVERALL CONCLUSION

According to both the information provided in the DBP and the Commission 2018 autumn forecast, the structural balance is projected to remain above the medium-term objective in both 2018 and 2019. The debt reduction benchmark is projected to be complied with in 2018, and the debt-to-GDP-ratio is projected to fall below the 60% Treaty reference value in 2019.