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Germany steers for budget consolidation

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On 26 November, the Bundestag passed the budget law proposed by the CDU/CSU-FDP government coalition. The budget law envisages moderate cuts in spending by 4.5% to 257 billion euros, owing to which the budget deficit will be reduced to 48 billion euros (4% of GDP). The budget passed this year is the first step in the four-year programme for budget consolidation. This is a consequence of the constitutional debt brake which imposes on the German government the obligation to reduce spending by approximately 7.5 billion euros annually until 2016.

The cuts planned in this budget law will not be drastic owing to the strong economic recovery in Germany and as a consequence much higher than expected budget revenues . At the same time, the federal government has decided to reduce public spending and to introduce new taxes in order to ensure higher budget gains. However, the government coalition will probably have to make major budget cuts in the next few years.

Budget savings in the immediate future will determine Germany's stance on the European Union's financial perspective for 2014–2020. German will also continue to promote debt cutting in other countries which, in Germany's opinion, will allow the euro to regain credibility on the financial markets.

Internal and external conditions for this year's budget law

The previous CDU/CSU-SPD government coalition in June 2009 included a regulation imposing a 'debt brake' in Germany's constitution. Pursuant to this, the upper limit of structural deficit will be 0.35% of GDP from 2016, with the deficit being reduced in equal stages, starting from 2011. The structural deficit, unlike the budget deficit, does not take into account short-term outlays, such as stimulation packages or budget spending resulting from unemployment rate changes, In practice, this allows for a higher level of budget deficit during recession, which can be lowered significantly when the economic situation improves. The budget brake will force the new government to cut structural spending by approximately 7.5 billion euros annually until 2016.

Another regulation which has forced the federal government to control the size of the budget gap is the Maastricht criteria. According to these, the budget deficit of each eurozone member state may not exceed 3% of GDP. Germany, as with the significant majority of eurozone members, has failed to meet the criteria – Germany's deficit last year reached 3.3% of GDP and this year has exceeded 4.5% of GDP. The federal government has taken steps to bring the deficit below the 3% limit by 2012. It wants to fulfil this undertaking even more so because in this way it will be able to apply pressure on the other eurozone

member states and return reliability to the common currency.

Priorities in the budget consolidation

The recently approved budget is unlikely to require excessive sacrifices from the public, which is an effect of the much higher than expected economic growth in Germany this year. The government assumed in the previous budget law that Germany's GDP in 2010 would grow by 1.2%, while in reality the country's economy has been developing almost three times faster and is likely to reach a growth rate of around 3.4%, which will result in higher tax revenues. Additionally, the good economic situation has contributed to a stabilising of the labour market. At the end of 2009 unemployment in Germany affected 3.42 million people (8.2%). Meanwhile, this number had fallen to 2.9 million by November 2010. As an effect of the cautious budget estimates and positive economic trends, the German budget deficit in 2011 will be 30 billion euros lower than planned, i.e. it will reach 48.4 billion euros, with spending at the level of 307 billion euros (4.2% less than a year before).

This year the government has updated its plans to bring down the budget deficit in 2010–2014. The budget strategy for the next four years is based on consolidating the budget through new taxes and moderate cuts in public spending.
Tax revenues are to increase mainly as a result of the imposition of a new tax on nuclear power plant operators, banks, financial transactions and air traffic. The nuclear power plant tax of 145 euros per gram of nuclear fuel burnt is an effect of a compromise with energy corporations and the government's consent to extend the operation period for the nuclear power plants. This tax will contribute approximately 2.3 billion euros to the budget annually, starting from the next year. The bank tax for future bailouts will be imposed depending on the risk incurred by individual banks. Although the government officially classifies it as a premium for the financial system stabilisation fund, the revenues of around 1 billion euros generated by the premium will also go to the budget. Additionally, an air traffic tax will apply from the next year and is expected to generate revenues at a level of 1 billion euros annually. The government is also planning to introduce a tax in 2012 on financial transactions to guarantee annual budget revenues of around 2 billion euros.
In turn, budget outlays will be lower mainly as a result of cutting social spending by 8.3%. The savings will be achieved through the allocation of smaller sums for labour market support by ending the subsidisation of workplaces endangered by the crisis, which was introduced as part of the stimulation package, and by limiting infrastructural expenses. Worth noting is an increase in the budget of the Ministry of Defence by 1.3%, which is linked to the costs of the reform of the Bundeswehr. Defence spending is expected to decrease gradually in the coming years. Spending on the Ministry of Agriculture will be reduced by 5.2%, which in the longer term may add significance to direct subsidies for German farmers from EU funds. The science and education budget will be 7.3% higher. Despite the savings, social spending will still exceed 50% of total budget expenses.

Prospects

1. The debt brake principle was introduced with the aim of a durable reduction of the deficit in the German state budget. This is linked to the need to lower total public debt, especially in

the context of the continually ageing German society and the costs this entails. To offset its effects, budget consolidation will be a priority task in the next few years. Germany believes that the restrictive fiscal policy will better protect its economy from crises in the future because the budget will administer more funds for stabilising the economy.

2. Both the government and the opposition are propagating budget consolidation without imposing the burden on the poorest layers of society. The federal government is thus forced to increase revenues by imposing new taxes and by delaying structural reforms over the next few years. In the longer term, the new taxes will adversely affect the competitiveness of Germany as an investment location, for example in the air transport sector.

3. The government while introducing new taxes, such as the tax on banks or financial transactions, assumes that they will help it to achieve the debt brake goals. For this reason it will not agree for those revenues to become new sources of financing for the EU budget, which has been proposed by Janusz Lewandowski, the EU budget commissioner. The federal government will also apply pressure for lowering or freezing the EU budget perspective for 2014–2020. In the present budget perspective, covering the period from 2007 to 2014, Germany will pay approximately 164 billion euros into the EU budget and receive approximately 78 billion euros. However, in this context, the improving economic situation in Germany may deprive the government of its key argument: the need to restrict the EU budget as a consequence of the economic crisis.

4. The budget implementation may be exposed to risks such as a situation in the eurozone entailing the need to offer guarantees or loans to it's the next member states facing insolvency, as has been the case with Ireland and Greece.