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GERMAN FISCAL POLICY FACES DIFFICULT CHALLENGES

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KEY MESSAGES

↘ After the pandemic, fiscal policy is facing another major challenge as a result of the Ukraine war and the energy crisis. To date, however, medium-term debt sustainability has not been endangered by the necessary additional borrowing.

↘ All relief measures should be as targeted as possible. They should include energy-saving incentives and be focused on lower and middle incomes.

↘ A temporary financial participation by those who can shoulder the high prices could reduce the fiscal burden and limit the inflationary effect.

SUMMARY

Even before the coronavirus pandemic and its fiscal implications have been fully dealt with, **German fiscal policy is facing the next major challenge**. The Russian war of aggression on Ukraine and the restriction of Russian energy supplies have led to considerable economic disruption and a high level of uncertainty, and have further increased the already rising inflation.

To meet these challenges, the state has again borrowed on a large scale. This was made possible by prolonging the **application of the debt brake's exception clause** to 2022. As a result, the **debt-to-GDP ratio** has **increased significantly** compared to the pre-coronavirus year 2019. Nevertheless, the **sustainability of Germany's public finances is not at risk in the medium term**. Firstly, the debt-to-GDP ratio was relatively low before the crises and, secondly, the debt-to-GDP ratio is likely to decline in the coming years, not least because of the high nominal economic growth caused by inflation.

The sharp rise in energy prices has led to the introduction of extensive relief measures for households and companies. In order not to place an unnecessary burden on public budgets, the measures should **ideally** provide **targeted relief for private households** that cannot cope with the high energy prices, and for companies that have a viable business model in the medium term. At the same time, energy-saving incentives should not be undermined. Of the **relief measures announced to date**, **some** are indeed **specifically** tailored to households with low and medium incomes. **However, this contrasts with a number of broad-based measures**, such as the fuel rebate, the nine-euro ticket and the flat-rate energy prices for all wage and salary earners, which also favour households that can in fact shoulder high prices. Furthermore, such measures give false incentives. As a result, the fiscal burden and inflation-driving demand stimuli are higher than necessary. Against this backdrop, the timing of measures to reduce tax-bracket creep also seems unfavourable. Although this measure is correct in principle, it should be postponed. Measures such as **taxable one-off payments or the gas-price brake are not ideal** in terms of precise targeting, **but under the current conditions** they are a **sensible solution** that can be implemented in the short term; the fact that of gas-saving incentives are to be maintained in this context is to be welcomed. An unbureaucratic and quick relief instrument should be developed as soon as possible to enable targeted relief for households in the future,

In order to make targeting more accurate, dampen inflationary stimuli and reduce the fiscal burden, it might be worth considering a **temporary revenue-side counter-financing of the relief measures** – for example by means of a **temporary increase in the top tax rate or** an **energy solidarity surcharge**.

I. INTRODUCTION

160. Before **the coronavirus pandemic** with its massive fiscal impact **has fully subsided**, German fiscal policy is already facing the **next major challenge.** The Russian war of aggression on Ukraine and the restriction of Russian energy supplies have led to severe economic disruptions and great uncertainty, and have further increased the already rising inflation. The Federal Government has therefore initiated financial relief for companies and private households and provided funds for **energy security** and for improving **defence capabilities**. As a first step, a supplementary budget was added to the budget for 2022 to cover additional expenditures. The funds available for defence were substantially increased by a special fund of €100 billion for the next five years. On top of this, additional substantial funds of up to €200bn will be provided as part of the 'defence shield' to relieve the pressure on households and companies from the high energy prices.

161. The targeted **relief measures for private households**, which are discussed in detail below, vary with regard to their precision. Three dimensions must be distinguished when it comes to targeting. First, the measures should be tailored as specifically as possible to the relevant problem areas, i.e. they should prioritise energy uses where price increases cause particularly heavy burdens. Second, the measures should be precisely targeted in terms of distribution, i.e. be limited as far as possible to households with lower and middle incomes. By concentrating relief measures on households that cannot cope with high energy prices – i.e. households that would have liquidity problems or face social hardship without government assistance – both measures help ensure that public budgets are not unnecessarily burdened. Third, the relief measures should be designed in such a way that energy-saving incentives are not undermined. Relief measures are also being introduced for companies. Support should be given to those companies that are particularly affected by energy price increases and have a viable business model in the medium term. ↘ ITEM 273

162. The child bonus, the emergency child supplement for low-income families and the heating cost subsidy for recipients of housing benefit are targeted transfers to the lower income groups. However, **many relief measures for private households** – such as the increase in the commuter allowance, the fuel rebate, compensation for tax-bracket creep, the cut in VAT on natural gas or the postponement of the next increase in the carbon price – have been **less targeted** in terms of distribution policy, as they also relieve households that can bear the burden.

Since some of the measures adopted or announced make the consumption of fossil fuels cheaper, they are also **not targeted when it comes to incentives to save energy**. Such measures lead to an inefficient distribution of limited fiscal resources, and also risk further driving macroeconomic demand and thus the inflation process if supply becomes scarce.

163. As early as the end of 2021, the Federal Government announced in its coalition agreement its intention of applying the **exception clause** to the **debt brake** in 2022 (SPD, Bündnis 90/Die Grünen and FDP, 2021), and officially decided to do

so with the Budget Act in June 2022. This additional net borrowing beyond the limits of the debt brake was originally intended to provide the financial means to cushion the ongoing consequences of the coronavirus pandemic in 2022. In early June 2022, the exceptional financial burdens resulting from the war were added as justification for applying the exception clause (Deutscher Bundestag, 2022a) and for the supplementary budget 2022 (Deutscher Bundestag, 2022b). Furthermore, under the defence shield announced in late September 2022, substantial additional net borrowing is to be posted under the exception clause for 2022 and transferred to the Economic Stabilisation Fund (WSF) as a special fund. These funds are to be available outside the debt brake beyond 2022, but may only be used to overcome the energy crisis (BMF, 2022a, p. 11). This construction is intended to enable compliance with the regulatory limits of the debt brake in 2023.

164. **Despite** the additional **challenges, fiscal consolidation** in the coming years is necessary to **ensure long-term sustainability**. ↘ ITEM 218 The relatively low level of public debt prior to the coronavirus pandemic, for example, helped make it possible to borrow on the financial markets on a large scale during the subsequent crises without debt sustainability being called into question. Such a starting position should be striven for again with regard to future demands and crises. **At the same time**, in the current crisis situation, the first and most important **task of fiscal policy is to provide sufficient funds for crisis management** without neglecting transformative tasks such as the energy transition. In addition to mobilising funds for public investment, policy should strengthen the framework conditions for sustainable growth and the incentives for private-sector capital formation.

If the public financial resources required to meet these upcoming tasks cannot be shown within the framework of the existing financial plan, there are basically **three possible ways to create financial leeway**: net new borrowing could be temporarily expanded again, expenditures in the existing financial plan could be reprioritised, or revenues could be increased. ↘ ITEMS 197 F.

II. INITIAL POSITION IN FISCAL POLICY

165. The German state has drawn on extensive financial resources – e.g. for business aid, short-time working allowances, child bonuses and vaccine procurement – to cope with the coronavirus pandemic. At the same time, tax revenues were significantly lower due to the crisis. As a result, net borrowing by the Federal Government was €130.5bn in 2020 and €215.4bn in 2021. ↘ CHART 45 The exceptionally **high borrowing** was **made possible** in each case **by the application of the exception clause of the debt brake**. ↘ BACKGROUND INFO 8

The federal budget **for 2022** was not passed until the current year because of the change of government (Economic Outlook 2022 box 5). With the justification of pandemic-related expenditure needs, the **exception clause** was **again applied** and net new borrowing in the draft budget law of March 2022 was set at €99.7bn, well above the upper limit of the debt brake. A **supplementary budget** passed at the end of April 2022 incorporated the additional financing needs **caused by the Russian war of aggression** into the budget, increasing the estimated new net borrowing to €138.9bn. ↘ CHART 45 Use of the exception clause allows for an increase in net new borrowing for the current year to the extent that the additional expenditure or revenue shortfall is related to the reason for activating the exception rule. For an additional overrun of the borrowing permitted under the debt brake, only a further Bundestag resolution which takes into account a corresponding repayment plan is required (Deutscher Bundestag, 2022c).

↘ BACKGROUND INFO 8

Exception clause of the debt brake

The federal debt brake contains an **exception clause** in Article 115 (2) sentence 6 of the Basic Law, which can be applied "in the event of natural disasters or exceptional emergency situations beyond the control of the state and significantly affecting the state's financial situation [...]". This requires a decision by a majority of the members of the Bundestag ('Chancellor majority'). The clause **allows the upper limit for net borrowing to be exceeded**, which is determined by taking into account the maximum permissible structural net borrowing, the balance of financial transactions and the business cycle adjustment. Net borrowing exceeding this limit must be accompanied by a repayment plan.

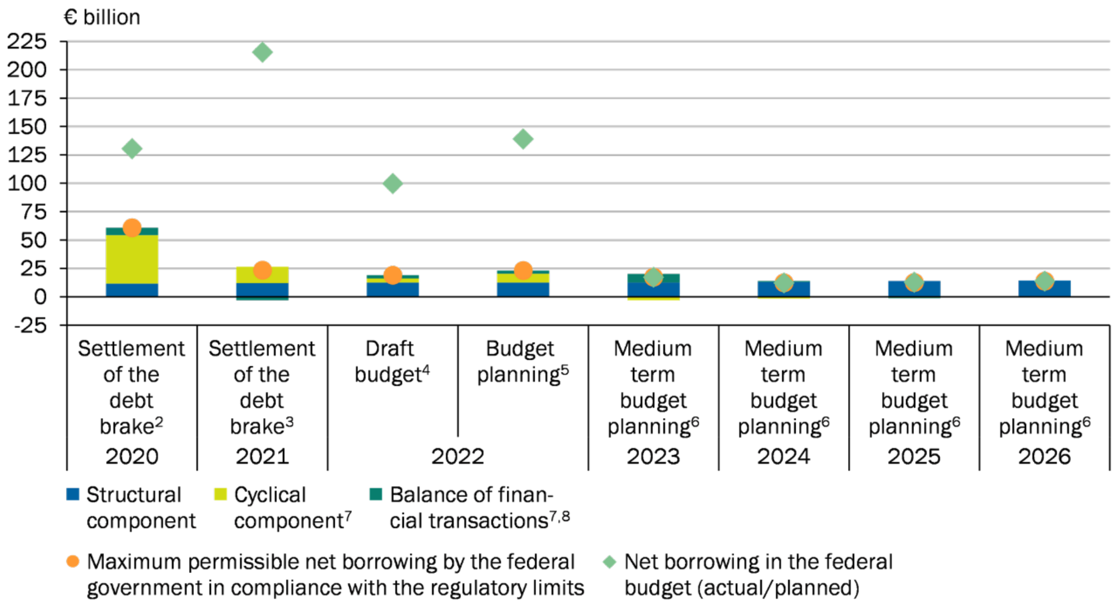
166. In addition to borrowing within the framework of the 2022 federal budget, substantial resources have been provided to two special funds. The **Bundeswehr Special Fund** will have access to **€100bn** over the next five years in addition to the defence budget to finance defence expenditure. The Bundeswehr Special Fund was anchored in the Basic Law by means of an individual construction with its own credit authorisation, so that it is independent of the federal budget and completely exempt from the regulations of the debt brake. Nevertheless, it included repayment plan that is to take effect from 2031 at the latest and apply for an appropriate period of time (Section 8 (2) of the BwFinSVermG).

167. At the end of September 2022, as part of an "economic defence shield against the consequences of the Russian war of aggression", the Federal Government also announced that it would provide the **Economic Stabilisation Fund (WSF)** with a credit authorisation of **€200bn** (Bundesregierung, 2022a). The reorientation of the fund originally set up to deal with the economic consequences of the coronavirus pandemic is intended to finance the measures to overcome the energy crisis up to and including the year 2024. These include the financing of the **gas-price brake** and the **electricity-price brake**, insofar as the funds from the planned skimming off of windfall profits in electricity generation are not sufficient for the latter. In addition, there will be liquidity and equity support for companies in distress due to the consequences of the war, as well as finance for gas procurement by gas importers that are relevant for market stability and are in difficulties due to the war.

As a **special fund with its own credit authorisation**, the WSF is also **independent of the federal budget**. Therefore, no supplementary budget is necessary to increase its funding. Unlike the special assets of the Bundeswehr, however, the WSF's credit authorisations are **relevant for the debt brake.** At the beginning of 2022, the accounting practices of the special assets were changed within the framework of the debt brake; now, the decisive date for consideration in relation to the debt brake is when funds are added, not when they are spent (BMF, 2022b). The measure thus increases net borrowing in 2022, which is planned anyway beyond the regulatory limits as a result of the application of the exemption rule; it also increases future repayment obligations.

168. With the announcement of the plans for the WSF, the Federal Government reaffirmed its intention to **comply with the debt brake's upper limit in 2023** for the first time since 2019. Excluding the WSF, this would require a reduction in net borrowing from €138.9bn in 2022 to €17.2bn in 2023. ↘ CHART 45 Apart from the Bundeswehr and WSF Special Funds, the **expenditure planned** so far **in the 2023 federal budget** is 10.2 % lower than in the previous year. However, at an expected €445.2 billion, it is still **considerably higher than in the pre-crisis year 2019**. Similarly, according to the current financial planning, it is higher than those of the following three years up to 2026. ↘ CHART 46 Compliance with the upper limits of the debt brake while simultaneously maintaining high planned expenditures in the 2023 federal budget is made possible in particular by

↘ CHART 45
Net borrowing in the federal budget in the medium term[1]



1 – Excluding borrowing from special funds with their own borrowing authority, such as the Bundeswehr Special Fund or the Economic Stabilisation Fund (WSF). 2 – As of 1 September 2021. 3 – As of 1 September 2022. 4 – As of 18 March 2022. 5 – As of 19 June 2022. 6 – As of 5 August 2022. 7 – Figures shown with inverted signs. 8 – Financial asset-neutral transactions in which cash movements are accompanied by offsetting entries in receivables or liabilities, such as privatisation proceeds or loans granted. The structural net borrowing relevant for the debt brake is adjusted for financial transactions, so that e.g. a sale of participations in the debt brake does not influence the structural net borrowing and thus cannot contribute to compliance with the credit limits (BMF, 2022c).

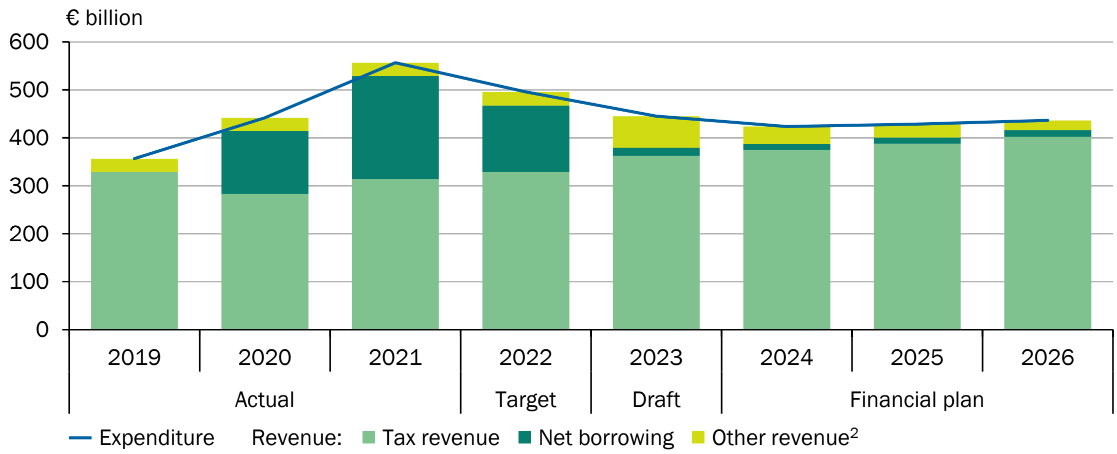
Sources: BMF, Deutscher Bundestag, own calculations the withdrawal of €40.5bn from the general reserve (formerly the 'asylum applicants and refugees' reserve) of currently €48.2bn, which was built up in the years before the coronavirus pandemic (Deutscher Bundestag, 2022d, p. 9).

169. In addition, there is expenditure financed by **other special funds** that were already partially filled from the federal budget in previous years, such as the Climate and Transformation Fund (KTF). These funds were also taken into account in the context of the debt brake at the time when the special funds were filled, so that their **expenditure** in the coming years **will not be relevant for the debt brake**. The KTF is expected to generate expenditure of €35.4bn in 2023 (Deutscher Bundestag, 2022d). Financing is to come from the withdrawal of about €10bn from the fund's reserves as well as from the fund's own revenues, especially proceeds from emissions trading.

170. The federal budget and the **reported net borrowing** thus paint an increasingly **incomplete picture of the** Federal Government's **actual expenditure and debt development**. The special funds open up considerable additional financing scope in the coming years. In relation to the debt brake, this expenditure has already been booked, but it largely consists of credit authorisations. The actual borrowing and thus the change in the Federal Government's debt level will therefore take place in the coming years (BMF, 2022c, pp. 7 f.). Apart from legal issues – for example, a complaint by the CDU/CSU parliamentary group is pending before the Federal Constitutional Court against the filling of the KTF in the second supplementary budget 2021 – such large-scale use of reserves and special assets can be criticised for lack of transparency. For example, according to media reports (FAZ, 2022), the Federal Audit Office criticises the fact that, due to the financing via reserves and special assets, the Federal Government's actual net borrowing is

↘ CHART 46

Expenditure and revenue in the federal budget in the medium term[1]



1 – From 2022 according to the „Federal Financial Plan 2022 to 2026“ of August 2022, therefore without taking into account more recent relief packages such as the funds for the Economic Stabilisation Fund (WSF). 2 – This includes, for example, revenue from warranties or the truck toll. In 2023, the withdrawal from the general reserve in the amount of €40.5 billion is particularly significant.

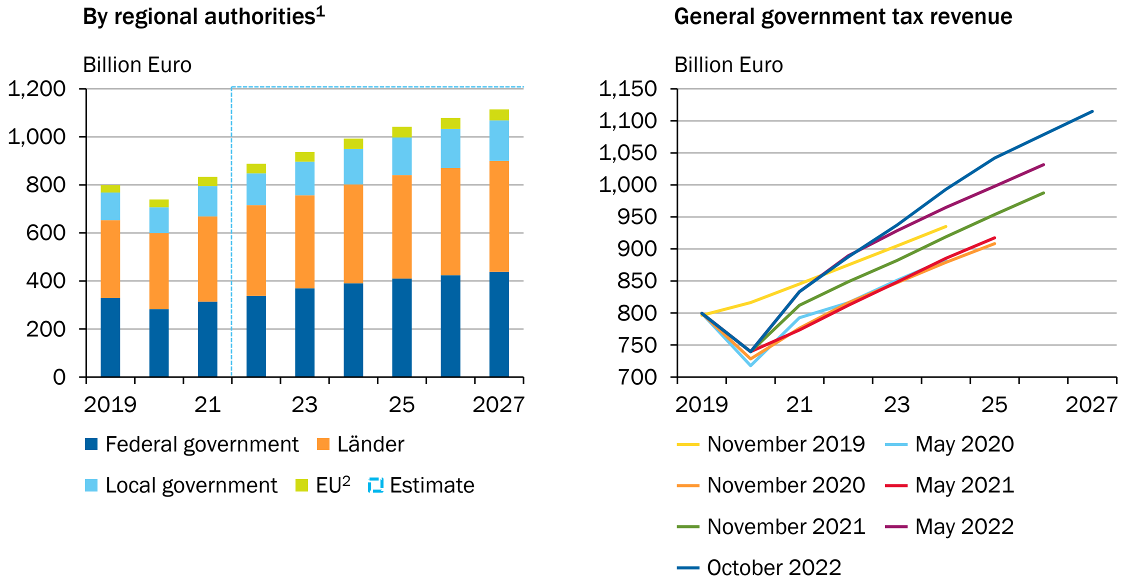
Source: Federal Government Financial Plans likely to be not €17.2bn but a total of €78.2bn and is thus intransparent. This criticism was made even before the cabinet decision on the WSF. Furthermore, in view of rising interest rates, the timing of borrowing is becoming more important. The cost of borrowing increases if the actual borrowing takes place at a later date with higher interest rates. However, these costs may not have been adequately taken into account at the time when the credit authorisations were granted.

171. The **development of government finances** over the coming years will depend on various factors. The possible scope of net borrowing in the federal budget will depend first of all on the cyclical adjustment of the debt brake. This allows net borrowing of more than the upper limit of 0.35 % of gross domestic product (GDP) in bad economic times and less than the upper limit in good economic times (BMF, 2022d). The expected economic slowdown ↘ ITEM 66 could, however, create additional burdens for budget planning in the coming years caused by the impact of the automatic stabilisers, such as cyclically lower tax revenues.

In addition to the current budget planning, there will be **further burdens** as a result of the announced measures to relieve private households and companies. However, it is difficult to foresee how much relief will actually be needed. Nevertheless, a broad framework for such aid has been set until 2024 with the €200bn defence shield.

172. The **forecasts on the development of tax revenues for the current and coming years** have increasingly **improved** since the tax estimate in May 2021. ↘ CHART 47 RIGHT Since the May 2022 tax estimate, expected tax revenues have been above the expectations of the pre-coronavirus tax estimate. A significant part of the upward revision is due to the expected strong inflation-driven increase in

↘ CHART 47
Rising general government tax revenues



1 – Result of the 163rd meeting of the "Arbeitskreis Steuerschätzungen" (Working Party on Tax Revenue Estimates) of October 2022. 2 – Tax revenue paid to the EU.

Sources: BMF, Working Party on Tax Revenue Estimates, own calculations nominal variables. ↘ ITEM 212 Tax revenue growth is projected for all levels of local government. ↘ CHART 47 LEFT Since the reform of the Länder fiscal equalisation system in 2020, the expected revenue of the Länder has been higher than that of the Federal Government. The most recent tax estimate from October 2022 led to a noticeable upward revision of expected tax revenues, although most of this will not begin until 2024. Any changes in the current and coming year will be small.

173. The **sustainability of Germany's public finances is unlikely to be affected in** the short and medium term, despite the very high planned borrowing. The fact that the German debt-to-GDP ratio was relatively low before the coronavirus pandemic is also a factor here. Moreover, the increase from 58.9 % of GDP in 2019 to 68.7 % in 2021 was much more moderate than in many other EU member states. ↘ ITEM 208 The high inflation rates should imply that the debt-to-GDP ratio falls again in the near future. ↘ ITEM 212 The GCEE forecasts a debt-to-GDP ratio of 68.0 % for the current year and 68.1 % for 2023.

III. CRISIS-RELATED DEMANDS ON FISCAL POLICY

174. The pandemic-related financial measures, for example in the social sector and in statutory health insurance, will still account for around 14.9 % of planned federal expenditure in 2022 (BMF, 2022e; own calculations). However, the consequences of the Russian war of aggression on Ukraine have created and continue to create unforeseen, high financial demands on the federal budget. In Germany, the **high inflation** in particular ↘ ITEM 67 is currently presenting private households and companies with major financial challenges. Among private households, those with low incomes are particularly hard hit, as the **sharp rise in energy costs** takes up a larger share of disposable income. ↘ ITEMS 122 F. Among companies, those that are energy-intensive and simultaneously compete outside Europe are particularly hard hit. ↘ ITEM 327 The Federal Government has taken a number of relief measures to cushion the consequences for domestic households and companies.

175. The **crisis-related expenditure** varies in terms of its time horizon and economic impact. The long-term, transformative expenditure – e.g. to implement and accelerate the energy transition – has an **investment character** and could contribute to increasing prosperity in the future. In order to be successful in the long term, transformation expenditure must be accompanied by a strengthening of the framework conditions, for example in climate protection in the form of carbon pricing (GCEE Special Report 2019 items 107 ff.).

In the short term, expenditure to relieve households is also necessary to protect them from temporary **liquidity bottlenecks** caused by higher energy prices, and to avoid social hardship. Relief for companies should target energy-intensive firms and those with a business model that is sustainable in the medium term. The more the measures are limited to targeting lower and middle incomes, the more likely they are to avoid fuelling inflation. By contrast, transfer payments that are spread too widely and also relieve households that are actually able to cope with the higher energy prices without assistance could have an unnecessarily inflationary effect. ↘ ITEM 153

1. Crisis-related security of the energy supply and expansion of defence capability

176. **Decarbonisation** is one of the key medium- and long-term challenges of economic policy. The Climate Protection Act (Deutscher Bundestag, 2021) states the aim of achieving net greenhouse-gas neutrality by 2045. The Russian war of aggression on Ukraine has changed the framework conditions for transformation. Furthermore, there is an urgent need for action to **secure energy supplies** in the short and medium term and to become **independent of Russian energy supplies**. ↘ ITEMS 333 FF.

177. In order to increase the security of supply for the winter, it was important to ensure the rapid **filling of the natural gas storage facilities** in the short term. ↘ ITEM 293 This was hardly economical for the gas storage operators in view of high import prices. In the medium term, the supply of natural gas is to be secured by imports of liquefied natural gas (LNG) instead of Russian deliveries of natural gas. This means building **LNG terminals**, which have been lacking until now, and connecting them to the German gas-supply infrastructure. The Federal Government leased floating LNG terminals on a short-term basis in April 2022. In addition, the construction of LNG terminals has begun. ↘ BOX 14 The Government has budgeted just under €3bn for construction and operation over the next ten years (Handelsblatt, 2022).

178. The war has brought Germany's defence capability into focus. The shortcomings of the **Bundeswehr's equipment** are to be remedied quickly. To this end, €100bn has been made available with the new Bundeswehr Special Fund. Expenditure of only €8.5bn from the special fund is initially planned for 2023 (Deutscher Bundestag, 2022e, p. 2221). At the same time, the Federal Government has reaffirmed its commitment to permanently meet NATO's target of spending 2 % of GDP annually on defence. Over the past five years, military spending (as defined by NATO) has averaged 1.37 % of GDP (NATO, 2022). Compliance with the NATO target would require additional funds to be made available from the regular federal budget in the long term after the resources from the special fund have been exhausted.

179. Germany has provided Ukraine with financial resources for the **purchase of military equipment and material** from Bundeswehr stocks. The total value of individual licences for exports of military equipment since January 2022 is around €797 million (Bundesregierung, 2022b). Another emergency programme of the Federal Ministry of Economic Cooperation and Development is valued at €185 million (BMZ, 2022; Deutscher Bundestag, 2022f), which is disbursed to partner organisations on the ground such as the Ukrainian disaster management, the International Organisation for Migration and the United Nations Children's

Fund. In addition, medical supplies worth around €100 million have been provided (BMG, 2022a, 2022b). The KfW Group has pledged loans of €300 million to Ukraine (KfW, 2022).

2. Crisis-related relief measures

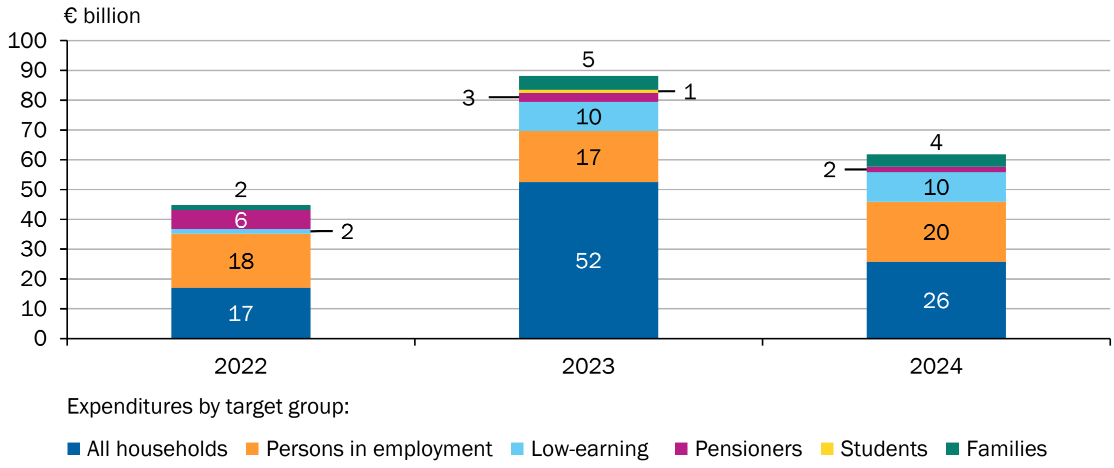
180. Rising energy prices pose major challenges for private households and companies. Low-income households in particular can face major financial difficulties as a result of high energy prices. ↘ ITEM 122 Not all companies can pass on the higher prices in full. They could therefore face liquidity or solvency problems. Fiscal policy can **alleviate** the financial consequences of the additional burdens in the **short and medium term**. German fiscal policy has already taken extensive measures to this end, which are intended to support companies ↘ ITEM 345 and private households.

The €5bn energy cost containment programme tailored to energy-intensive companies is intended to help cushion the increased **energy costs**. ↘ ITEM 344 However, it has hardly been used to date (BAFA, 2022). Individual gas-importing companies such as Uniper have also received extensive governmental support. In addition, there are extensive **guarantees and KfW loan programmes** to support energy-intensive companies. However, these will only have a limited impact on the budget, which cannot be quantified at present. The aforementioned short-term measures are now to be replaced by the **gas- and electricity-price brake** until 2024. Of the estimated costs of the gas-price brake, about €30bn is likely to go predominantly to companies with RLM contracts. ↘ GLOSSARY However, it is hardly possible to distinguish between private households and small companies since the gas connection contracts are very similar.

181. A sum of around €195bn is to be mobilised in the coming years within the framework of three relief packages and the replenishment of the economic and stabilisation fund. ↘ TABLE 16 APPENDIX The largest part of this, €133bn, is earmarked for relieving private households in 2022 and 2023. ↘ CHART 48 The measures are direct and indirect monetary **transfers to private households** (child bonus, one-off payments for recipients of benefits under Books II and XII of the Social Security Code [SGB II and SGB XII], flat-rate energy payments to people in employment, pensioners and students), **tax and contribution reductions** (e.g. adjustments to employee's standard allowance for work-related expenses, the commuting allowance and the basic tax-free allowance (income tax), a suspension of the increase in the national carbon price and the planned reduction of tax-bracket creep ↘ BACKGROUND INFO 9), **benefit reforms** (citizen's income ['Bürgergeld'], increase in child benefit, increase in housing benefit), **energy subsidies for end consumers** (electricity-price brake, gas-price brake) and **mobility subsidies** (fuel rebate, nine-euro ticket). The costs of all these planned measures can still decrease or increase significantly depending on (global) political and economic developments.

↘ CHART 48

General government expenditure on relief for private households by recipient groups[1]



1 – A household may belong to several target groups. Status: 28 October 2022.

Sources: Deutscher Bundestag, Federal Ministry of Finance, own estimates

↘ BACKGROUND INFO 9

Reduction of tax-bracket creep

In the case of a progressive tax rate, a **wage increase** that merely compensates for inflation leads to an **increase in the tax rate**, even though there has not been an increase in real income. In order to compensate for this effect, in recent years the tax rates in the Income Tax Act have been regularly adjusted to the respective price development on the basis of the progression report. The revenue losses to the state caused by such a tax-rate adjustment would be particularly high in the current year because of the high level of inflation. In addition to the recently announced shift in the income tax rates, there are plans to increase the basic tax-free allowance, the tax allowance for dependent children, and child benefit.

182. Slightly more than half of the relief measures, around €95.4bn, are directed at all households. This means that assistance is also given to high-income households that could bear the burden themselves. Another €55.5bn will be spent on supporting taxpaying persons in employment. The **largest individual item** of these expenditures is the **reduction of bracket creep** from 2023 onwards. ↘ BACKGROUND INFO 9 This is expected to lead to a revenue shortfall of about €8.3bn in 2023. There will also be related forms of relief such as the additional increases in the tax allowance for dependent children and in child benefit amounting to €3.8bn. All measures related to the reduction of bracket creep in all packages will amount to €12.2bn in 2023 and €17.9bn in 2024. The total amounts involved in the relief can still increase if, after presentation of the progression report, the tariff benchmarks have to be adjusted to a higher inflation rate than hitherto assumed.

183. Some relief is directed specifically at low-income households, which can be assumed to be the most in need. Pensioners and students will also be supported. Some of the relief measures represent **fundamental reforms and increases**

in state transfer payments which will have to be taken into account in the public budget after 2022. However, some of these measures, e.g. citizen's income ('Bürgergeld'), were already part of the coalition agreement. Overall, the measures intended for these groups make up a **relatively small percentage** at around 17 % **of the total expenditure of €195bn**, and are mainly limited to 2023.

3. Distributional effect of the relief for households

184. In order to limit public spending and **avoid additional inflationary pressure**, the relief measures should be targeted as **precisely** as possible at those private households that will have liquidity problems without government assistance, or are threatened with social hardship. Without financial support, these households would have to take tough steps to restrict their consumption as a result of the additional financial burdens. Bach and Knautz (2022) therefore recommend focusing on low-income households when designing the relief measures. At the same time, the energy technologies used by households, e.g. for heating, have a decisive influence on the level of pressure they experience. As a result, even middle-class households with gas heating or poor thermal insulation could suffer financial distress as a result of rising natural gas prices and would have to be helped in accordance with their needs (Kalkuhl et al., 2022; Kellner et al., 2022b). In addition to relieving low-income households, users of certain energy technologies should therefore also be relieved on a needs-oriented basis (Kalkuhl et al., 2022; Kellner et al., 2022b).

185. The growing financial difficulties manifest themselves in a significant **increase** in the percentage of **private households at risk of energy poverty**. One possible approach considers households to be at risk of energy poverty if they spend more than 10 % of their disposable income on energy (Henger and Stockhausen, 2022; Schreiner, 2015). Henger and Stockhausen (2022) use this definition and the latest sampling period of the Socio-Economic Panel (SOEP) up to 2020, together with an update of the data for aggregate total expenditure on energy, as well as the price index for household energy issued by the Federal Statistical Office up to May 2022. They find a significant increase in the number of people in energy poverty from 14.5 % in 2021 to 25.2 % of the total population in May 2022. When energy poverty is defined as spending more than 10 % on energy and, in addition, having an income of less than 60 % or 80 % of the median, the proportion is correspondingly smaller in each case, but also shows a marked increase in 2022.

A look at the households' assets also shows that the high additional accumulation of savings during the coronavirus crisis was not enough to absorb the energy price shock (Behringer and Dullien, 2022). These additional savings were already almost completely used up by higher expenditure on consumption in the first quarter of 2022 (Wollmershäuser, 2022). Moreover, 29 % of households in Germany had no or negative net wealth (figures for 2017) (GCEE Annual Report 2019 item 629). In addition, **many lower-income households** did not build up **any additional savings** during the coronavirus crisis (Behringer and Dullien, 2022). Yet it is these households that have to spend a high proportion of their income on energy and have no means to compensate for the price increases by liquidating savings or temporarily reducing savings formation (Behringer and Dullien, 2022).

186. Bach and Knautz (2022) estimate the average relief provided to households in the first two packages (without taking into account the nine-euro ticket) at 1.3 % of annual net household income. The **relief effect in the lowest decile** is **higher** (3.7 %) **than in the highest income decile** (0.7 %). Lower income groups benefit, for example, from the emergency child supplement for low-income families, the child bonus and the heating cost subsidy for recipients of housing benefit. The flat-rate energy payment and the abolition of the EEG surcharge also reduce the financial burden. On the other hand, it is mainly higher income groups that benefit from the increase in the employee's standard allowance for work-related expenses and the long-distance commuter allowance, as well as from the fuel rebate. Overall, **low-income households** remain **the group most burdened** in relative terms by the sharp price increases, because of the high proportion of household income that they have to spend on consumption. ↘ ITEM 123 For example, the net burden and relief for the lower deciles of income distribution result in an average burden of about 3 %. This burden falls to only 1.3 % in the top decile (Bach and Knautz, 2022). With regard to targeting, Boysen-Hogrefe (2022) also criticises the planned reduction of bracket creep, as this measure disproportionately benefits high-income households.

187. Kellner et al. (2022b) also conclude that households with low incomes, as measured by their consumption level in 2018, are given more relief than households with higher consumption. Similar to Bach and Knautz (2022), Kellner et al. (2022b) conclude that the child bonus and emergency child allowance, the one-off allowance for benefit recipients and the heating cost allowance for low-income earners specifically help the lower income groups. In addition, the flat-rate energy payment and the abolition of the EEG surcharge benefit lower incomes slightly more. However, many other measures are more broadly based. For example, middle and high incomes also benefit significantly from the **fuel rebate**, which is associated with high fiscal costs. The increases in the employee's standard allowance for work-related expenses and the basic tax-free allowance also favours middle incomes. In the view of Kellner et al. (2022b), the **regressive increase in the long-distance commuter allowance** has proved to be **unsuitable**.

The high proportion of income spent on energy by the lower income groups ↘ ITEM 122 is not fully compensated by the relief measures. After balancing additional burdens against relief payments, the **lower income groups**, especially the lower middle class, therefore remain the most burdened groups relative to their income (Kellner et al., 2022b).

IV. ECONOMIC POLICY CONCLUSION

188. The Russian war of aggression on Ukraine requires extensive fiscal policy measures. The targeted relief **of private households** due to the sharp rise in energy prices is **necessary** to cushion social hardship and prevent lasting damage to economic development. At the same time, in view of the physical scarcity of important energy sources, the necessary incentives to save energy must be maintained. In addition, expenditure is needed to ensure energy security and defence capability in the short term. These tasks have arisen in a situation where the fiscal consequences of the coronavirus pandemic are still lingering.

189. The **medium-term sustainability of Germany's public finances does not** appear to be **at risk** at present. The strong nominal economic growth in 2022 contributes significantly to a declining debt-to-GDP ratio despite the high level of net borrowing. However, in view of changing economic conditions, long-term sustainability must continue to be ensured when planning future public finances. To this end, the **debt-to-GDP ratio** must **follow** a **sustainable path with an adequate risk buffer**. In addition, financial leeway must be available at the same time to tackle future-oriented tasks and ensure long-term sustainable economic growth.

190. In the years 2020 to 2022, **appropriate fiscal responses** were **possible by using the debt rule exception clause**. The economic consequences of the war in Ukraine could justify the renewed use of the exception to the debt brake in 2023. From today's perspective, the federal budget in 2023 can comply with the regulatory limits of the debt brake by using the general reserve amounting to approximately €40bn. However, if this reserve is used in 2023, it will **no longer be available in 2024**. Although the immediate effects of the coronavirus pandemic and the Ukraine war on the federal budget are likely to be declining by then, economic development could still be fragile. Compliance with the regulatory limits without the possibility to draw on reserves to a greater extent could then lead to high consolidation pressure and a correspondingly strong negative fiscal impulse.

191. The transfer of fiscal capacity to special funds must be viewed critically in terms of **budget transparency**. In particular, there is a significant time lag between the allocation of credit authorisations – and thus accounting – under the debt brake and the actual borrowing. This means that the costs of the interest burden are not foreseeable at the time of the loan approval, which entails the risk of an unexpectedly high burden on future state budgets if interest rates rise. In the case of the **Bundeswehr Special Fund**, it is not apparent why this expenditure cannot be financed in the regular budget. This is especially true against the background of the long-term need for defence spending and the commitment to meet NATO's 2 % target in the regular budget once the Special Fund's funds have been fully spent.

192. The use of the **WSF** with an altered purpose to finance the easing of energy costs represents a construction which, on the one hand, could **narrow down and specify the purpose of expenditure** more **precisely** than might have been

the case if the exemption clause from the debt brake had been used again in the coming year. On the other hand, it is **difficult to understand why credit authorisations** should already be granted in **the 2022 financial year** to finance expenditures that will **arise mainly in 2023 and 2024**.

193. Certain relief measures specifically target low- and middle-income households. On the other hand, there are also **several broad-based and cost-intensive measures** that also reach or even favour households with higher incomes. These **seem unsuitable** in terms of providing targeted relief, since the limited fiscal resources should be used in a targeted manner, and potentially inflationary demand stimuli should be avoided (Boysen-Hogrefe, 2022; Kellner et al., 2022b). For example, **reducing bracket creep** is desirable in principle to prevent an increase in the tax burden. In view of the fiscal policy situation, however, it is questionable whether bracket creep should also be reduced as usual in 2023, not least because many relief measures are **not targeted**. Against this background, it would seem logical to postpone the reduction of bracket creep.

The **burden** of energy price increases remains **relatively the highest on lower-income households.** They may therefore be inadequately protected in a prolonged period of high gas prices and high inflation. Since they have few options to adjust their behaviour, for example by reducing or drawing on savings or by credit-financed consumption, future measures should target low-income households even more precisely (Boysen-Hogrefe, 2022). Furthermore, measures should always set energy saving incentives to counteract energy scarcity (Bach and Knautz, 2022; Kalkuhl et al., 2022). Against this background, the adverse incentive effect of the fuel rebate, for example, should be criticised, since it did not encourage fuel saving.

194. An **unbureaucratic and quick relief instrument** would be desirable to make targeted relief for households possible. However, none exists at present. Taxable one-off payments are a good instrument under the current conditions, as they relieve the lower income groups somewhat more in absolute terms. In addition, an income limit on relief in this form could be considered in order to maintain targeting accuracy and only provide relief to households that need state support.

Another reason why the measures taken so far are not targeted precisely enough is the fact that it is not possible to make transfers to all households based on burdens and incomes. There is still no tried-and-tested way for the state to make one-off payments to all population groups. A transfer payment could, for example, be made via the health insurance funds, as they cover 99.92 % of the entire population (Federal Statistical Office, 2019). However, this mechanism requires a substantial period for preparation, is not very visible and cannot reach people with no health insurance (Kellner et al., 2022a). An alternative could be to set up a system of **direct payments** using **the tax identification number**, as prepared by the Federal Government in the Annual Tax Act 2022 (Deutscher Bundestag, 2022g). Such a system could enable income-dependent payments and thus have a more targeted effect. Moreover, it could be designed in a comparatively unbureaucratic and cost-efficient way if it builds on an existing infrastructure (Färber and Wieland, 2022).

195. **The European gas price** has **decoupled from the price in the United States** since the beginning of 2021 and has **risen significantly** since then. ↘ ITEM 8 Russia's halting of natural gas supplies via the Nord Stream 1 Baltic Sea pipeline in September 2022 further restricted the gas supply. Since the risk that Russia might halt natural gas supplies has already existed since spring 2022, work on designing incentive-compatible relief measures for energy price increases should have begun in the spring. Against this background, the reaction of German fiscal policy in September 2022 clearly came too late. Targeted relief to offset increases in natural gas and electricity prices should now be implemented quickly.

The Expert Commission on Gas and Heat (ExpertInnen-Kommission Gas und Wärme, 2022) proposes a **gas-price brake** in this context. If the brake is implemented as proposed by the Expert Commission, consumers will receive a one-off rebate in December 2022 reflecting the consumption on which the instalment payment in September 2022 is based. In the second stage of the brake, from March 2023 onwards, the instalment payment for private households is to be reduced monthly by a flat-rate amount that is not dependent on actual consumption in 2023. This amount will be calculated from the product of a price component and a volume component. The volume component (called a quota in the proposal) is 80 % of the consumption estimate on which the instalment payment is based. The price component is calculated as the difference between the contract price and 12 cents per kWh. ↘ ITEM 62 The balance of a gas bill should not become negative over the year. In principle, this model makes sense in order to cushion the burden of energy price increases. The necessary energy-saving incentives are preserved as far as possible, but not the incentive to replace the heating system. ↘ ITEM 339 However, the incentives will have to be communicated in an understandable way. The proposed taxation of the **relief as a non-cash benefit** would ensure that less relief is paid to higher income groups and that the costs for the state are to some extent limited. However, the measures must not offer incentives for gas suppliers to raise prices above market levels in order to unjustifiably siphon off state payments.

196. In addition to their short-term stabilising effect, relief measures should also pursue the goal of **bringing about improvements in the energy supply that** are **structurally necessary** anyway. For example, the abolition of the EEG surcharge, in addition to providing financial relief, helps to drive the transition to an electricity-based energy system. Postponing the increase in the carbon price is counterproductive, however. Further relief could take its orientation from the energy price reform proposed by the GCEE (GCEE Annual Report 2020 item 391) and include, for example, **cutting the electricity tax to the European minimum**. Spending on energy security should take into account the future structure of a climate-neutral energy economy. In this respect, it is to be welcomed that the Federal Government is, from the outset, promoting facilities to also handle green hydrogen in parallel with LNG at the planned terminal in Wilhelmshaven (BMWK, 2022).

197. Financing long-term tasks, such as achieving the NATO 2 % target and the energy transformation, may require a **new prioritisation of public spending**. A **reduction in climate-damaging subsidies** could increase financial leeway in

the medium term, but it is hardly feasible in the short term. A comprehensive cut in subsidies should be well prepared, taking into account the distributional impact, and implemented step by step. Furthermore, the **framework conditions for private capital formation** should be **improved** at the same time, since the private sector is of crucial importance in the financing of transformation projects. ↘ ITEM 201

198. Measures that ensure at least partial revenue-side counter-financing of the relief could be a good idea. Depending on their design, however, these would place an additional burden on households and companies and could have a dampening effect on growth. Attention should therefore be paid to a targeted and moderate design. Especially against the background of the current problems in designing relief measures that are well targeted, it would seem conceivable to supplement these measures with more targeted increases in taxes and levies. For example, a **temporary increase in the top tax rate** or a **strictly time-limited energy solidarity surcharge for top earners** might be considered. This would limit public borrowing and with it the fiscal stimulus. The inflationary effect of the relief measures could be reduced. The time limit could, for example, be linked to the duration of the gas or electricity price brake. The negative growth effect would most likely remain manageable in the event of such temporary measures.

APPENDIX

↘ TABLE 16

Total government expenditure on relief for private households by recipient groups[1]
€ billion

	2022	2023	2024	Total	
All households	**17.1**	**52.5**	**25.8**	**95.4**	
9 Euro Monthly ticket June to August 2022	2.5				X
Nationwide local transport ticket from 2023 (€49 - €69)		3.0	3.0		
Earlier (as of 1.7.2022) abolition of EEG surcharge	6.6				X
Gas price brake (Commission proposal)	5.0	40.0	20.0		X
Remaining funds in the special federal funds for cultural events	1.0				
Reduction of value added tax for gas to 7 %	2.0	6.5	2.8		X
Extension of reduced value added tax in gastronomy		3.0			
Persons in employment	**18.1**	**17.2**	**20.1**	**55.5**	
Reduction of bracket creep of income taxation					
Increase of the basic tax-free allowance from €10,347 to €10,632 from 1.1.2023		2.2	2.4		
Increase of the basic tax-free allowance from €10,632 to €10,932 from 1.1.2024			2.3		
Shift on tariff benchmarks by 5.76 % from 1.1.2023		6.1	7.0		
Shift on tariff benchmarks by 2.49 % from 1.1.2024			2.8		
One-off energy price lump sum of €300	10.4				X
Deferral and increase of the home office lump sum		1.0	1.0		
Increase in employee lump sum from €1,000 to €1,200	1.7	1.3	1.2		X
Increase of the basic tax-free allowance from €9,984 to €10,347 from 1.1.2022	2.7	3.1	3.1		X
Increase of the commuter lump sum to 38 cents		0.3	0.3		X
Inflation premium		1.5			
Reduction in energy tax on fuels June to August	3.2				X
Extension of the peak compensation by on year		1.7			
Extension of short-time allowance	0.1	0.04			X
Low-earning	**1.6**	**9.8**	**9.9**	**21.2**	
Increase midi-job limit to €2,000		1.3	1.3		X
One-off allowance for low-earning	0.4				X
One-off grant for benefit recipients of €200	0.7				X
Introduction of citizen's income		4.8	5.1		
Higher housing benefit		3.7	3.4		
Second heating cost allowance	0.6				X
Pensioners	**6.3**	**3.0**	**1.9**	**11.2**	
One-off payment pensioners	6.3	0.1			X
Early abolition of so-called double taxation (pension)		2.9	1.9		
Students		**1.0**		**1.0**	
0.0		1.0			
Families	**1.8**	**4.7**	**4.1**	**10.6**	
One-off child bonus of €100 per child	1.4				X
Increase in child supplement		0.2			
Child benefit increase and child allowance (reduction of bracket creep of income taxation from 2023)					
Increase in the child allowance from €8,388 to €8,548 from 1.1.2022		0.2	0.3		
Increase in the child allowance from €8,548 to €8,688 from 1.1.2023		0.01	0.2		
Increase in the child allowance from €8,688 to €8,916 from 1.1.2024			0.2		
Increase in child benefit from 1.1.2023		3.6	2.8		
Immediate supplement for families with low income (€20 per month from 1.6.20	0.4	0.7	0.7		X
Total expenditure on relief	**44.9**	**88.2**	**61.8**	**194.8**	

1 – A household can belong to several recipient groups. „X“ means that the measure was passed in the Bundestag. As of 28 October 2022.

Sources: Deutscher Bundestag, Federal Ministry of Finance, own estimates

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