Federal Ministry
of Finance

26th Subsidy Report

Federal government report on trends in federal financial assistance and tax benefits for the years 2015 to 2018

Summary report

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I. Introduction

The federal cabinet adopted the federal government's 26th Subsidy Report on 23 August 2017. In accordance with section 12 of the Act to Promote Economic Stability and Growth (*Gesetz zur Förderung der Stabilität und des Wachstums der Wirtschaft*), every two years the federal government submits to the Bundestag and Bundesrat an overview of federal financial assistance and tax benefits. The report is submitted in conjunction with the government draft of the federal budget.

The federal government's subsidy policy reflects the prudence and reliability of its overall fiscal policy. In particular, the intensified implementation of the federal government's subsidy policy guidelines and the targeted design of assistance measures help to ensure the efficient use of financial resources for the purpose of facilitating the forward-looking development of the German economy. Subsidies that are no longer necessary are wound down, and new subsidies are introduced in areas where they can boost competitiveness or provide temporary support for the advancement of pro-growth technologies. The federal government's regular Subsidy Reports provide the German Bundestag and the federal government with the information needed to conduct reviews of subsidies.

The federal government's 26th Subsidy Report outlines trends in federal financial assistance and tax benefits during the period from 2015 to 2018. This English-language summary report presents the main findings of the full report. The full report is available in German on the website of the Federal Ministry of Finance, www.bundesfinanzministerium.de. In addition to the information contained in this summary, the full report includes standardised data sheets for the individual financial assistance items and tax benefits.

II. Subsidy policy and definitions

Under certain conditions, subsidies can be a legitimate instrument of fiscal policy in the social market economy. The decisive factor here is their impact in terms of growth, redistribution, competition and the environment. Subsidy policy must therefore also take into account the external effects of assistance measures as well as their redistributive effects and potential knock-on costs. Public assistance can help level out regional disparities (one example here is “Improvement of regional economic structures”, a programme funded jointly by the Federation and the *Länder*), create incentives for the broad-based introduction of technological innovations, accelerate the market entry process and facilitate structural adjustment.

However, subsidies always require special justification, together with regular evaluations of their efficiency and success. This is because long-term favourable arrangements that benefit individual market participants at the expense of others generally have adverse effects. For example, by altering relative prices over a sustained period, subsidies can lead to economic distortions and the misallocation of resources. In addition, subsidised companies can crowd competitive companies out of markets. Furthermore, subsidies pose the risk of creating a dependency culture, or a “subsidy mindset”, with the result that recipients fail to make the necessary adaptations and are less inclined to tackle structural challenges. These problems can delay crucial structural adjustments, cause a loss of international competitiveness, and impede economic growth and employment. For this reason, subsidies should generally be both temporary and degressive by design.

Subsidies also require special justification in connection with their potential impact on the environment, not only in terms of resource consumption but also in terms of the costs arising from the need to mitigate environmental and health-related damage. The federal government regularly assesses whether subsidies that make short-term sense can be replaced over the medium term with market-based solutions that are not dependent on government budgets. Putting in place climate-friendly fiscal and tax policies also calls for the ongoing reduction of subsidies that have an adverse impact on the environment. In this context, the impacts that any modifications might have on low-income households or on the international competitiveness of affected economic sectors are also duly taken into account.

2.1 The federal government's subsidy policy guidelines

The federal government follows subsidy policy guidelines that serve to enhance the subsidy system's transparency, accountability and governance (see Box 1). The guidelines constitute a voluntary commitment by the federal government regarding the way that it handles subsidy measures under its remit. They must be taken into account every time a new subsidy is introduced or an existing subsidy is modified.

Box 1

Subsidy policy guidelines
(as agreed in the federal cabinet decision of 28 January 2015)

- New subsidies shall be granted only if they are the best-suited instrument and are efficient on a cost-benefit basis, compared with other measures.
- New subsidies shall be granted preferably as financial assistance and shall be financed from savings elsewhere.
- New financial assistance shall be both temporary and degressive by design.
- The objectives of financial assistance shall be formulated in a way that makes it possible to evaluate the success of such measures.
- Federal subsidy policy shall take into account the impact of subsidies on growth, redistribution, competition and the environment. The federal government's Subsidy Reports shall explain whether or not subsidies are sustainable.
- As a rule, all subsidies shall be subject to regular evaluation in terms of target attainment, efficiency and transparency.
- Existing tax benefits shall be reviewed with a view to replacing them with financial assistance or other measures that place a smaller burden on public finances.
- Time limits and, in general, degression rules shall be introduced for existing financial assistance items and for financial assistance items not yet designed to be temporary and degressive.

New subsidies must undergo especially rigorous scrutiny before they are introduced, because entrenchment hinders subsequent change. Recipients often claim that subsidies are the only feasible option, although in some cases the same outcome could be achieved at far lower cost by other means, such as regulatory measures. Against this background, and given the ongoing need to consolidate public finances, all new subsidies – including tax benefits – must be immediately, permanently and fully offset by savings elsewhere.

Tax benefits often have the same effect as a spending programme and indeed are sometimes referred to as "tax expenditures". However, tax benefits have a number of disadvantages compared with financial assistance. They are not capped by budget appropriations and are not part of the annual budget preparation process. In most cases the size of the revenue shortfall can only be estimated. Tax benefits can generate deadweight losses, tend to become entrenched, and run the risk of quickly ceasing to be regarded as subsidies. Tax expenditures financed from joint tax revenues have the same effect as joint tasks carried out with federal, *Länder* and local authority funding in accordance with the respective formula for allocating tax revenue. Changes in the law in such cases require the consent of the Bundesrat.

For all of these reasons, tax benefits prove difficult to reform and control. For this reason, new subsidies – to the extent that they are necessary – should preferably be granted as financial assistance, and evaluations of existing tax benefits should check whether it would be feasible to convert such benefits into financial assistance items or regulatory measures (see definition of "financial assistance" and "tax benefits" in section 2.2 below).

In contrast to tax benefits, the federal government generally carries a higher level of responsibility when it comes to modifying existing financial assistance. Financial assistance can be modified in many cases on the basis of federal government guidelines or administrative agreements. Objectives must be precisely specified and continuously monitored. If the targeted objective has been attained or is no longer justified, if it cannot be attained with the type of measure in question, or if there is another, better means of attaining the objective, then a subsidy must be discontinued without delay. It is also essential to prevent separate measures from having contradictory effects or cancelling each other out.

In order to enhance accountability, the federal government expanded the subsidy policy guidelines by adding a passage requiring subsidies to be subject to sustainability impact assessments and, in general, to regular evaluation cycles.

By conducting sustainability impact assessments, the federal government is underscoring its intention to ensure that its subsidy policies are geared more towards the principle of sustainability. In general, the assessments are based on Germany's national sustainability strategy and the requirement – in effect since the 16th legislative term – to conduct sustainability impact assessments as part of overall regulatory impact assessments. Sustainability impact assessments of subsidies focus on their long-term economic, environmental and social effects.

Long-term subsidies for specific economic sectors can lead to subsidy dependence, and this risk is enough in itself to necessitate the ongoing review of subsidies. Furthermore, arguments used to justify the introduction of individual subsidies may lose their relevance over time. The federal government's commitment to conducting regular evaluations underscores its intention to make public finances more outcome-oriented and to make the effects of subsidies more transparent.

Adverse outcomes can be mitigated or prevented by designing subsidies to be temporary and degressive. The basic principle that financial assistance must be time-limited by design enables the federal government to review the effectiveness of assistance measures and, where appropriate, to discontinue or re-design them. While certain government functions are based on statutory or even constitutional provisions that cannot and should not be rendered time-limited by government decision, the federal government can nevertheless establish temporary framework plans or administrative agreements, particularly for functions like these. This provides a reason and an opportunity to regularly review how these functions are carried out. The rule that all financial assistance items must be temporary by design ensures that these same options can be put into place for measures that have hitherto not been subject to time limits.

2.2 Definition of subsidies

The subject matter to be covered in Subsidy Reports is stipulated in section 12 of the Act to Promote Economic Stability and Growth, and these rules have remained unchanged since 1967. *Financial assistance* is defined for this purpose as federal funds allocated to agencies outside the federal administration and deployed for the benefit of private businesses or economic sectors. *Tax benefits,* in turn, are special tax rules that lead to a reduction in public revenue.

In accordance with the statutory mandate, the definition of federal subsidies focuses on assistance to private businesses and economic sectors. Section 12 of the Act to Promote Economic Stability and Growth specifically describes financial assistance as federal funds used to support adaptation, maintenance and productivity in businesses and economic sectors. Assistance that does not fall into these categories is designated as miscellaneous financial assistance. Forms of assistance that directly reduce the prices of certain goods and services for private households but may indirectly boost the private sector are referred to as indirect subsidies. This applies, for instance, to assistance for housing construction.

A similar definition applies to tax benefits, which are classified in the same way as financial assistance. A special tax regulation is regarded as a subsidy – and hence as a tax benefit for the purposes of Subsidy Reports – if it directly or indirectly benefits specific sectors or subsectors of the economy. Tax benefits also include special tax regulations that directly benefit business and industry over the general public.

Federal expenditures on general state tasks (such as funding for basic research) do not count as subsidies, although it can be difficult to draw the line in individual cases. Federal guarantees also do not count as subsidies; the main reason for this is that the typically low risk of default makes it highly unlikely that budgetary resources will have to be spent. In any case, trends in federal and other guarantees are documented in the financial reports regularly published by the Federal Ministry of Finance. Grants and capital injections for federal enterprises are likewise not counted as subsidies. Other federal government reports provide targeted information on specific policy areas. For example, federal enterprises are covered in the Federation's report on government holdings.

Both the question of which specific arrangements are to be classified as subsidies as well as the general definition of subsidies for the purpose of the Subsidy Report are a recurring subject of academic and political debate. The Subsidy Report's general focus on assistance for private enterprises and economic sectors means that large areas of the federal budget are excluded that could be classified as subsidies using other definitions. In 2014, the federal government commissioned the FiFo Institute for Public Economics at the University of Cologne to conduct a study on “Institutional structures to improve the transparency and performance of subsidies”. One of the central aims of the study, which was published in September 2014, was to review the definitions used and the subject matter covered in the Subsidy Report. Based on a comparison and analysis of subsidy regimes in selected countries, the study lays out various options for improving German subsidy policy in terms of transparency and performance assessment. For example, the FiFo Institute recommended that subsidies be subject to regular evaluations and sustainability impact assessments. These recommendations were taken into account when the subsidy policy guidelines were expanded in January 2015.

III. Subsidy trends

The Subsidy Report's analysis and discussion of financial assistance focuses on the use of federal funding. Tax benefits, on the other hand, are reported on from different perspectives: first, the report shows the total size of tax revenue shortfalls resulting from tax benefits adopted by the federal legislature; second, it shows the size of the shortfall incurred at federal level. The Subsidy Report therefore also includes estimates of revenue shortfalls for other than federal jurisdictions. It also provides an overview of trends in *Länder*, local authority, ERP and EU subsidies. From a budget policy perspective, however, the focus is on federal-level revenue shortfalls and expenditures.

3.1 Trends in federal subsidies during the reporting period from 2015 to 2018

Total subsidies during the reporting period are projected to rise from €20.9 billion in 2015 to €25.2 billion in 2018 (see Figure 1). This €4.3 billion increase in the total volume of subsidies will be driven mainly by an increase in federal financial assistance.

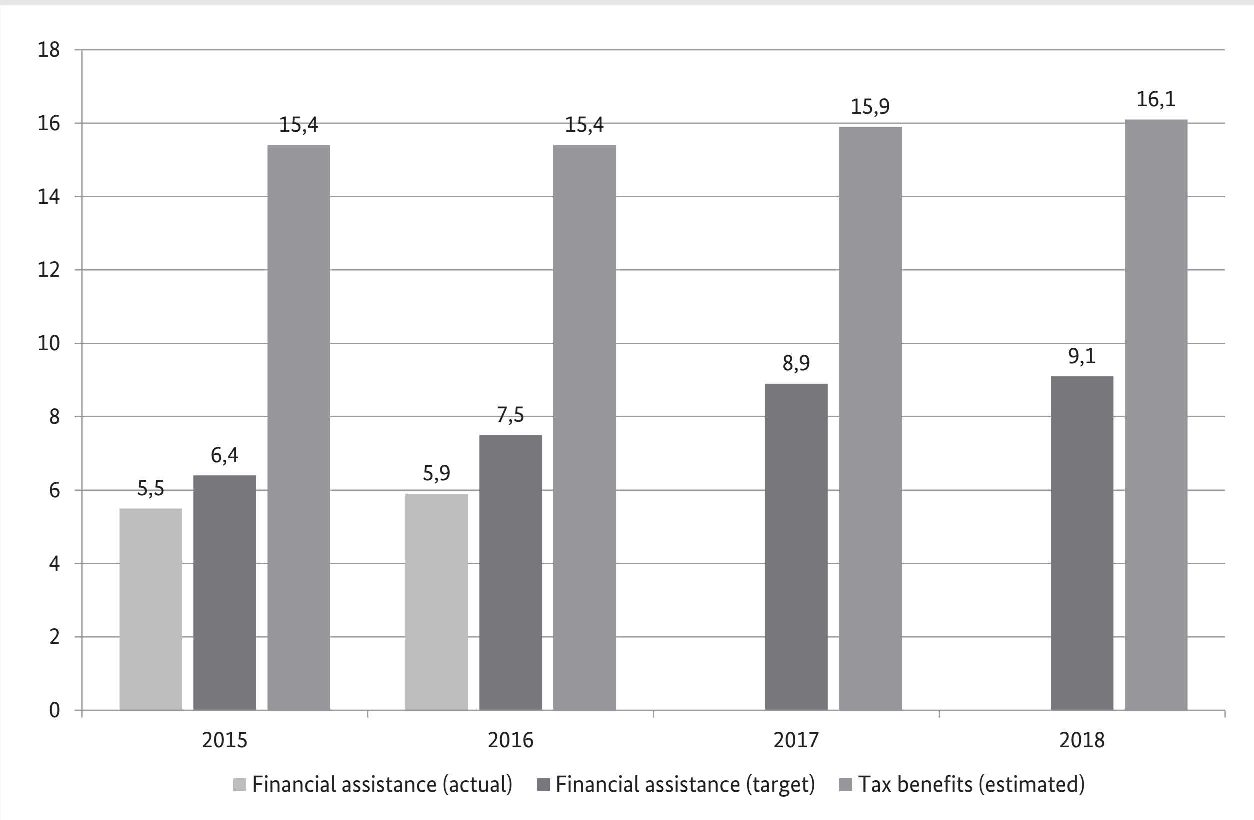
When looking at subsidy trends in Germany, it is important to take into account the fact that allocated budget funds in 2015 and 2016 were not drawn down in their entirety. Thus the discrepancy between target spending amounts and actual spending amounts overstates the increase in financial assistance between the previous reporting period, which ended in 2016, and the current reporting period. A comparison between the target spending amounts for 2016 and 2018 would show a €2.3 billion increase in total subsidies, but replacing the target figure with the actual figure for 2016 results in an increase of €3.9 billion. This means that the increase in total subsidies between 2016 and 2018 is overstated by €1.6 billion.

Financial assistance is set to grow by just under €3.6 billion during the reporting period. The largest increase – a difference of €3.0 billion between actual spending in 2016 and target spending in 2017 – is targeted towards forward-looking federal investments (which were allotted to individual ministries for the first time under the 2015 supplementary budget) and towards new financial assistance items. The individual subsidies that account for the greatest share of this increase are support for the nationwide expansion of broadband networks; measures to promote energy-efficient building refurbishment and to improve energy efficiency; a new financial assistance measure to optimise pumping and heating systems; and a new subsidy for purchases of electric cars.

Federal tax benefits are projected to rise from €15.4 billion in 2015 to €16.1 billion in 2018. The main factor driving this increase is the new tax benefit under section 8d of the Corporation Tax Act, which exempts loss carry-forwards from forfeiture pursuant to section 8c of the Corporation Tax Act, on the condition that the company in question maintains the same business operations.

To give an indication of how subsidy trends compare with economic and general budgetary trends, various subsidy ratios are shown in Figure 2. Financial assistance as a percentage of federal public spending declined steadily from 1997 to 2008 before rising in 2009 in response to the global

Figure 1: Federal financial assistance and tax benefits, 2015 to 2018



financial and economic crisis. Financial assistance as a percentage of federal spending rose from 1.8% in 2015 to 1.9% in 2016 and is projected to grow to 2.7% in both 2017 and 2018. Tax benefits as a percentage of tax revenue declined from 5.5% in 2015 to 5.3% in 2016. This figure is expected to remain constant at 5.3% in 2017 and is then projected to fall to 5.1% in 2018, its lowest level for the period covered in this report. Subsidies as a percentage of GDP amounted to 0.7% in 2015. This figure is expected to increase slightly to 0.8% in both 2017 and 2018 but remains at a historically low level.

3.2 Federal financial assistance

Federal financial assistance is projected to increase from an actual spending total of €5.5 billion in 2015 to an estimated total of €9.1 billion in 2018. There are a total of 70 federal financial assistance items; of these, the 20 largest individual items are expected to account for just under 90% of total financial assistance in 2018. The largest individual item during the reporting period will be (a) the KfW subsidy for energy-efficient building refurbishment measures, followed by (b) sales and decommissioning assistance for coal mining and (c) the energy efficiency fund.

Figure 2: Subsidy ratios

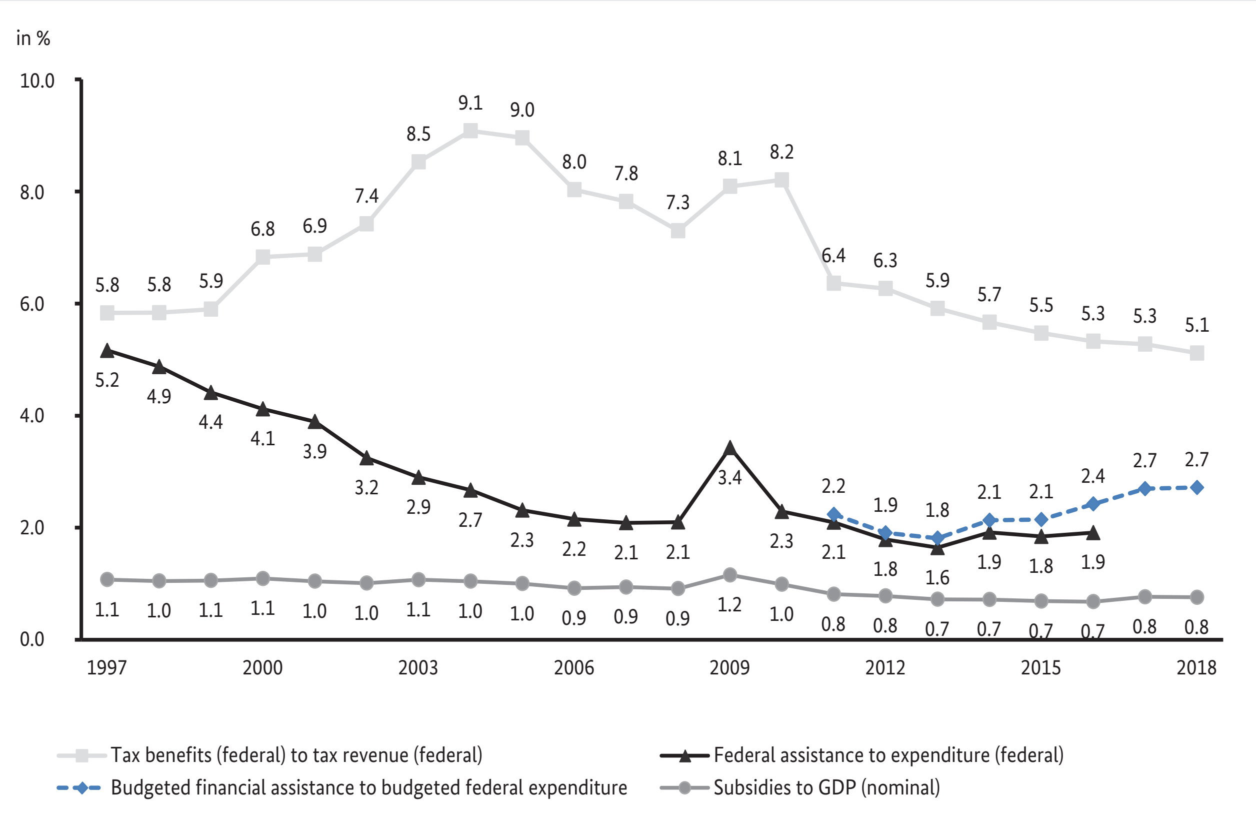


Table 1: The 20 largest federal financial assistance items

No	Chapter	Brief description of financial assistance item	No in Annex 1 of 26th Subsidy Report	2018 Govt. draft €m	2017 Target €m
1	2	3	4	5	6
1	09 03 60 92	KfW subsidy for energy-efficient building refurbishment measures	66	1,794	1,481
2	09 03	Subsidies for the sale of German coal for electricity generation, for sale to the steel industry and to offset the impact of capacity adjustments	12	1,020	1,054
3	60 92	Energy efficiency fund	15	653	463
4	12 04 12 10	Funding to expand and upgrade broadband networks	53	500	689
5	60 92	Optimisation of pumping and heating systems	21	470	346
6	10 03 60 02	Joint task "Improvement of agricultural structures and coastal protection"	8	445	530
7	09 02 09 10	Joint task "Improvement of regional economic structures"[1)]	37	437	437
8	12 01	Utilisation of distance-based commercial vehicle toll	58	387	387
9	16 02 60 02 60 92	National climate protection initiative	19	329	329
10	09 03 60 92	Subsidy for individual measures to promote renewable energy use	17	324	317
11	09 01	Central Innovation Programme for SMEs (ZIM)[1)]	23	314	317
12	60 92	Subsidies for the purchase of electric cars	52	275	192
13	16 06	Support for urban development	62	231	209
14	16 06	Premiums under the Home Ownership Savings Premium Act	70	223	265
15	60 92	Electricity price compensation	16	210	300
16	60 92	Competitive bidding for funding to promote electricity efficiency (STEP up! programme)	18	150	100
17	09 02	Support for SMEs, professional services and vocational training[1)]	38	133	132
18	04 52	Incentives to boost film production in Germany	44	125	50
19	09 03	Adjustment benefit for coal mining industry employees	13	103	109
20	10 01	Subsidies for agricultural accident insurance funds	1	100	178

1) Stated amount only a portion of budget amount.

3.3 Federal tax benefits

The Federation's revenue shortfall from tax benefits is expected to increase during the reporting period, from €15.4 billion in 2015 to €16.1 billion in 2018.

Like financial assistance, tax benefits are concentrated within a small number of categories. In 2018, trade and industry will account for the largest share of federal tax benefits at 49.7%, followed by miscellaneous tax benefits (27.0%) which consist mainly of tax benefits that directly benefit private households and that influence economic activity in key sectors. The third largest category of tax benefits targets the transport sector (14.3%). Over the course of the periods covered in recent Subsidy Reports, tax benefits for the transport sector and miscellaneous tax benefits have gained substantially in importance, while the significance of tax benefits targeting the housing sector has waned. Due to the discontinuation of the owner-occupied homes premium, tax benefits for the housing sector now account for just 0.5% of total tax benefits.

In 2018, the 20 largest tax benefits listed in Annex 2 to the 26th Subsidy Report are projected to account for 88.5% of the total revenue shortfall at the federal level (see Table 2). The largest individual item from the Federation's perspective is the reduced VAT rate for cultural and entertainment services, which is expected to cause a revenue shortfall of just under €2.1 billion in 2018. The largest tax benefit item overall is the tax concession for persons who acquire businesses or corporate shareholdings by way of gift or inheritance; in this case, revenue shortfalls are incurred in their entirety by the *Länder*. There was a sharp but temporary increase in the amounts involved here due to persons bringing forward the timing of estate transfers to their heirs in the form of gifts ahead of (a) a Federal Constitutional Court ruling delivered on 17 December 2014 (1 BvL 21/12; Federal Law Gazette 2015 I, page 50) and (b) reforms to inheritance and gift tax.

For the period covered by this 26th Subsidy Report, three new tax benefits were adopted that fall under the federal government's definition of subsidies. These benefits are projected to result in revenue shortfalls totalling €660 million, €208 million of which will be incurred at federal level. Moreover, none of the tax benefits cited in the 25th Subsidy Report expired.

Table 2: The 20 largest tax benefits

No	No in Annex 2 to the 26th Subsidy Report	Brief description of tax benefit	Revenue shortfall (€m) Revenue year 2018	
			Total	Federal
1	45	*Section 13a Inheritance Tax Act* Tax benefit for persons who acquire businesses or corporate shareholdings by way of gift or inheritance	5,700	-
2	99	*Section 12 (2) nos 1, 2, 12 and 13 VAT Act in conjunction with nos 49, 53 and 54 of Annex 2 to the VAT Act, and section 12 (2) no 7 VAT Act* Reduced VAT rate for cultural and similar services	3,915	2,089
3	95	*Section 3b Income Tax Act* Shift bonuses	2,815	1,196
4	39	*Section 35a (3) Income Tax Act* Reduced tax rate for renovation costs	2,050	871
5	54	*Section 37 and 53 Energy Duty Act* Energy duty relief for electricity generation	1,700	1,700
6	64	*Section 10 Electricity Duty Act* Electricity duty relief for manufacturing companies in special cases (*Spitzenausgleich*)	1,700	1,700
7	67	*Section 12 (2) no 10 VAT Act* Reduced VAT rate for public transport	1,410	753
8	100	*Section 12 (2) no 11 VAT Act* Reduced VAT rate on overnight accommodation	1,395	745
9	62	*Section 9b Electricity Duty Act* Electricity duty relief for manufacturing companies and agricultural and forestry businesses	1,000	1,000
10	92	*Section 10a Income Tax Act, Chapter XI (sections 79-99) Income Tax Act* Support for fully funded private pensions (subsidy amount)	995	423
11	63	*Section 9a Electricity Duty Act* Electricity duty relief for certain processes and procedures	800	800
12	36	*Section 8d Corporation Tax Act* Exemption of loss carry-forwards subject to the continuation of operations	660	198
13	101	*Section 12 (2) no 6 VAT Act* Dental technicians	575	305
14	79	*Section 27 (2) Energy Duty Act* Aviation fuels	570	570
15	53	*Sections 37 and 51 Energy Duty Act* Energy duty relief for certain processes and procedures	560	560
16	21	*Section 57 Energy Duty Act* Agricultural diesel	450	450
17	36	*Section 8c Corporation Tax Act* Restructuring and corporate group clause	350	105
18	51	*Sections 26, 37, 44 and 47 Energy Duty Act* Exemption for energy producers	350	350
19	19	*Section 3 no 7 Motor Vehicle Tax Act* Tractors and trailers	260	260
20	77	*Section 2 (2) Energy Duty Act* Tax relief for liquefied gas and natural gas used as fuels	210	210
1 to 20		**Total** % of tax benefits listed in Annex 2 to the 26th Subsidy Report	**27,465** 91.6%	**14,285** 88.5%

3.4 Federal subsidies in specific sectors

Trade and industry (including support for the clean energy transition or *Energiewende*) continues to account for the largest share of subsidies. Subsidies in this category are projected to increase from just under €11 billion in 2015 to €13.4 billion in 2018 (see Figure 3). The main factor driving this increase is the sharp rise in financial assistance to promote energy efficiency and renewable energy. In 2018, trade and industry are expected to account for 53.1% of all federal subsidies.

Federal subsidies in the transport sector will increase slightly during the reporting period, from €2.4 billion in 2015 to a projected €3.0 billion in 2018. The transport sector accounts for just under 12% of all subsidies and is the third largest subsidy category behind trade and industry and miscellaneous subsidies. The increase in transport sector subsidies is being led primarily by (a) a new grant to promote the construction of charging infrastructure for electric vehicles, (b) greater use of the reduced VAT rate for local public transport and (c) tax relief for liquefied gas and natural gas used as motor fuels.

Federal subsidies for housing will increase substantially during the reporting period, from €1.4 billion in 2015 to a projected €2.3 billion in 2018. The main factor behind this development is an additional increase in funding for the KfW subsidy to promote energy-efficient building refurbishment measures.

Federal subsidies in the category of food and agriculture are expected to grow slightly from just under €1.4 billion in 2015 to just under €1.5 billion in 2018. This increase is due primarily to (a) a top-up in the budget for the joint Federation/*Länder* task "Improvement of agricultural structures and coastal protection", (b) funding for a programme that offers energy-related advice to agricultural businesses and (c) a new tax benefit that evens out tax rates on income from agriculture and forestry over periods of three years.

Financial assistance in the category of savings and investment incentives will see another decline during the current reporting period, while tax benefits in this category will rise slightly. The main cause of this growth in tax benefits is an increase in tax relief for fully funded private pensions (known as "Riester pensions"), while the decline in financial assistance is being led by a decrease in the overall volume of the home ownership savings premium (*Wohnungsbauprämie*). Taken together, subsidies in the category of savings and investment incentives are projected to total €0.7 billion in 2018.

Miscellaneous tax benefits will increase over the reporting period, rising from just under €4 billion to just under €4.4 billion. The items posting the largest increases in this category are the reduced VAT rate for cultural and entertainment services, the reduced VAT rate on overnight accommodation, and tax exemptions on statutory or collectively agreed bonuses paid for working Sundays, holidays or nights.

Figure 3: Federal financial assistance and tax benefits by economic sector, 2015 to 2018

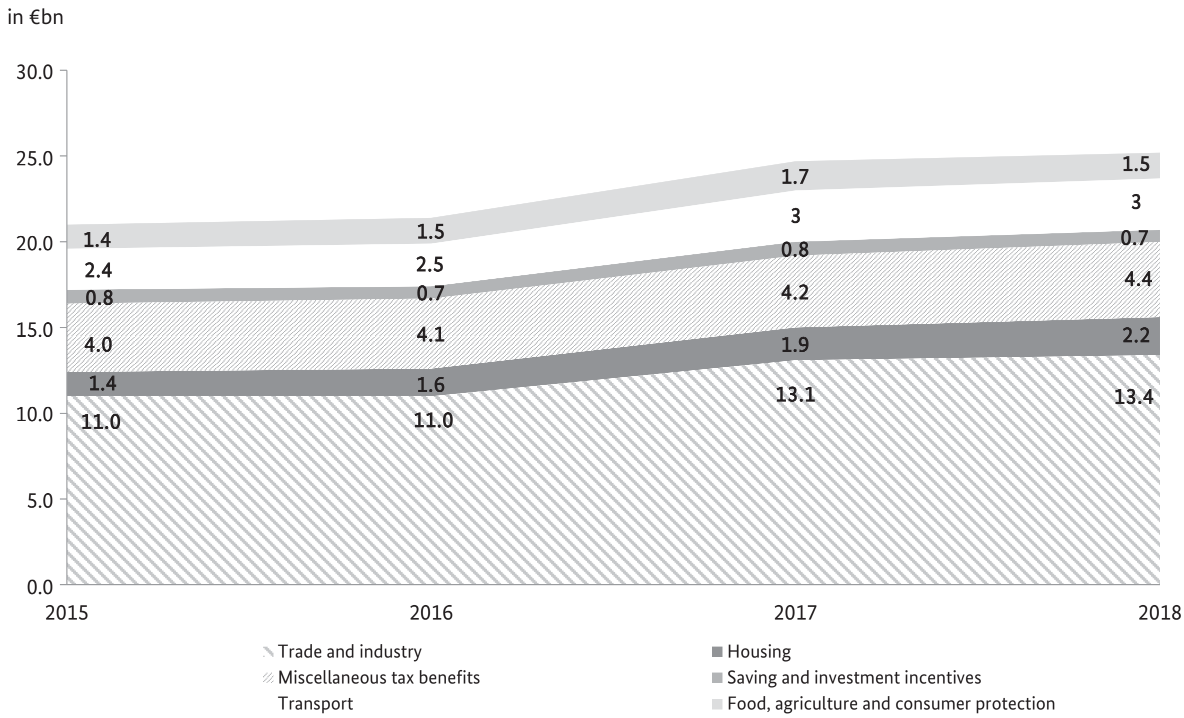


Table 3: Trends in federal financial assistance and tax benefits, 2015 to 2018 (in €m)[1)]

Category	2015			2016			2017			2018		
	Financial assis-tance	Tax benefits	Total	Financial assis-tance	Tax benefits	Total	Financial assis-tance	Tax benefits	Total	Financial assis-tance	Tax benefits	Total
	Actual			Actual			Budget			Govt. draft		
1. Food, agriculture and consumer protection	**556**	**806**	**1.362**	**640**	**821**	**1,461**	**883**	**858**	**1,741**	**621**	**849**	**1,470**
2. Trade and industry (excluding transport)												
2.1 Mining	1,200	-	1,000	1,395	-	1,395	1,162	-	1,162	1,123	-	1,123
2.2 Energy efficiency and renewable energy	630	-	630	782	-	782	1,889	-	1,889	2,167	-	2,167
2.3 Technology and innovation subsidies	416	-	416	417	-	417	445	-	445	440	-	440
2.4 Assistance for specific economic sectors	10	-	10	13	-	13	34	-	34	36	-	36
2.5 Regional structural measures	396	129	525	308	63	371	437	34	471	437	9	446
2.6 Other measures	363	7,825	8,188	333	7,660	7,993	1,208	7,913	9,121	1,178	8,018	9,196
Total (2)	**3,015**	**7,954**	**10,969**	**3,248**	**7,723**	**10,971**	**5,175**	**7,947**	**13,122**	**5,381**	**8,027**	**13,408**
3. Transport	**269**	**2,147**	**2,416**	**291**	**2,177**	**2,468**	**724**	**2,256**	**2,980**	**694**	**2,314**	**3,008**
4. Housing	**1,323**	**100**	**1,423**	**1,541**	**89**	**1,630**	**1,821**	**84**	**1,905**	**2,173**	**77**	**2,250**
5. Savings and invest-ment incentives	**379**	**445**	**824**	**223**	**502**	**725**	**265**	**510**	**775**	**223**	**521**	**744**
6. Miscellaneous financial assistance and tax benefits[2)]	**-**	**3,956**	**3,956**	**-**	**4,079**	**4,079**	**-**	**4,225**	**4,225**	**-**	**4,355**	**4,355**
Total 1 to 6[3)]	**5,542**	**15,408**	**20,950**	**5,943**	**15,391**	**21,334**	**8,868**	**15,880**	**24,748**	**9,092**	**16,143**	**25,235**

1) Totals may contain differences due to rounding.
2) Mainly tax benefits that directly benefit private households but affect business activity in important sectors of the economy.
3) Tax benefits estimated.

Table 4: Trends in tax benefits for the years 2015 to 2018, by category (in €m)

Category	2015		2016		2017		2018	
	Total	Federal	Total	Federal	Total	Federal	Total	Federal
1. Consumer protection, food and agriculture	**846**	**806**	**866**	**821**	**946**	**858**	**926**	**849**
2. Trade and industry (excluding transport)	**19,281**	**7,954**	**18,006**	**7,723**	**17,032**	**7,947**	**15,916**	**8,027**
2.1 Mining	-	-	-	-	-	-	-	-
2.2 Energy and raw material supplies	-	-	-	-	-	-	-	-
2.3 Technology and innovation	-	-	-	-	-	-	-	-
2.4 Assistance for specific economic sectors	-	-	-	-	-	-	-	-
2.5 Regional structural measures	269	129	132	63	71	34	20	9
2.6 Miscellaneous trade and industry (excluding 2.1, 2.2, 2.3, 2.4 and 2.5)	19,012	7,825	17,874	7,660	16,961	7,913	15,896	8,018
3. Transport	**2,771**	**2,147**	**2,819**	**2,177**	**2,933**	**2,256**	**3,014**	**2,314**
of this amount: - aviation fuel	570	570	570	570	570	570	570	570
- other transport	2,201	1,577	2,249	1,607	2,363	1,686	2,444	1,744
4. Housing and urban development	**236**	**100**	**209**	**89**	**198**	**84**	**182**	**77**
of this amount: -								
- section 7h, i Income Tax Act	85	36	85	36	85	36	85	36
- section 10f, g Income Tax Act	97	41	97	41	97	41	97	41
- Owner-occupied homes premiums	54	23	27	12	16	7	0	0
5. Savings and investment incentives	**1,045**	**445**	**1,180**	**502**	**1,200**	**510**	**1,225**	**521**
6. Miscellaneous tax benefits[1)]	**7,957**	**3,956**	**8,197**	**4,079**	**8,482**	**4,225**	**8,737**	**4,355**
Total 1 to 6	**32,136**	**15,408**	**31,277**	**15,391**	**30,791**	**15,880**	**30,000**	**16,143**

1) Mainly tax benefits that directly benefit private households but affect business activity in important sectors of the economy.

3.5 Overall subsidy trends by jurisdiction and government level

In accordance with the mandate laid down in the Act to Promote Economic Stability and Growth, Subsidy Reports provide an overview of the federal-level financial assistance items and tax benefits for each budget year. In addition to this, Table 5 outlines trends in federal, *Länder* and local authority subsidies as well as subsidies from the European Recovery Programme (ERP) and the European Union. For the first time, this report includes estimates of financial assistance granted by local authorities for the period up to and including 2018. As in past reports, data on *Länder* and ERP financial assistance and on EU market-related expenditure are not available for the entire reporting period.

The data on *Länder* financial assistance was provided by ZDL, the central data office of the *Länder* finance ministries. ZDL also performed the calculations of local authority financial assistance for this report, based on an analysis of relevant categories and functions; this is similar to the methodology it uses to calculate *Länder* financial assistance.

Previously, the figures used as a basis for extrapolating the local authority subsidy amounts cited in Subsidy Reports were taken from an RWI study produced in 1992. For the current Subsidy Report, the Federal Ministry of Finance asked ZDL to review whether figures for the local authority level could be calculated in essentially the same way that *Länder* figures are calculated so that, in the future, *Länder* and local authority data would be based on the same methodology.

For local authorities, subsidy figures were calculated using a set of categories and functions (i.e. budget headings for types of expenditures and functions) contained in the annual accounts of local authorities. This method of calculation shows that local authority financial assistance totalled €2.42 billion in 2011, a figure that exceeds the previously used extrapolation of €1.5 billion. An increase in the volume of local authority subsidies was expected, because a considerable number of functions have been outsourced from the core budgets of local authorities over the past 20 years. Subsequent figures for local authority subsidies were extrapolated from the 2011 (base year) figures based on the rates of change in net expenditures contained in local authorities' quarterly cash statistics.

Länder and local authority tax revenue shortfalls are estimated by the Federal Ministry of Finance. Figures on EU market-related expenditure and ERP financial assistance are also taken into account insofar as such figures are available.

To avoid double-counting, the financial assistance figures reported by the *Länder* are reduced by the amount of the federal share of *Länder* financial assistance already accounted for under federal financial assistance. The figures reported by the *Länder* are based on a uniform framework tailored to the purposes of federal subsidy reporting. This framework was developed in the 1980s on the basis of the general framework recommended by the Working Committee on Budget Law and the Arrangement of the Budget System. It is a purely technical solution used to calculated approximate figures for *Länder* financial assistance that falls under the definitions applied in the federal Subsidy Report. As the budget headings included are not examined in detail regarding the extent to which they constitute financial assistance, these figures are only indicative of trends in *Länder* subsidies. In 2012, changes were made to the system for classifying functions in the budget. To accommodate these changes, ZDL modified the framework for the reporting years from 2013 onwards. At the same time, in consultation with the *Länder*, ZDL made a number of substantive changes to the framework. As a result, trends in *Länder* financial assistance from 2013 onwards have only limited comparability with the years prior to 2013.

Länder financial assistance is projected to increase from an actual spending total of €8.4 billion in 2015 to a target of roughly €10.7 billion in 2017. As in previous reports, the size of this increase is partly a result of the difference between actual spending figures and budgeted targets. Assistance for trade and industry will register a particularly sharp increase of €1.7 billion from 2016 to 2017. This growth is due in part to investment funding allocated to local authorities (the Local Authority Investment Promotion Fund). Financial assistance in the housing sector is set to grow by over €750 million in 2017 due to additional federal allocations to the *Länder* for housing construction (these payments are referred to as “unbundling funds” that serve to back projects previously financed jointly by the Federation and *Länder*). Assistance in the area of food, agriculture and forestry will also grow significantly this year, by nearly €600 million, with topped-up agricultural assistance to the eastern *Länder* accounting for over half of this amount. In contrast to the Federation, which counts only one-third of its spending on urban development as financial assistance, the *Länder* treat 100% of their expenditures on urban development (excluding federal allocations) as subsidies. This means that *Länder* financial assistance figures in this area tend to be overstated.

ERP financial assistance stood at approximately €250 million in 2016. From 2008 onwards, the figures for ERP funding no longer represent the total amount of newly issued loans but rather only the subsidy amount, which is derived mainly from the reduced interest rates of these loans. This change in methodology had the effect of altering the overall total for 2016 by roughly €4.8 billion; this must be kept in mind when interpreting long-term trends.

The ERP Special Fund provides low-interest financing to support new businesses, SMEs in the trade and industrial sectors, and persons who provide professional services. In particular, ERP loans aim to support start-ups and innovation. The ERP Special Fund covers the interest rebate component, and the KfW is responsible for refinancing the loans. Table 5 shows the total amount of interest rebates granted for each year. The figures also include federal interest subsidies paid to the ERP Special Fund to boost the amount of funding that can be provided in specific areas.

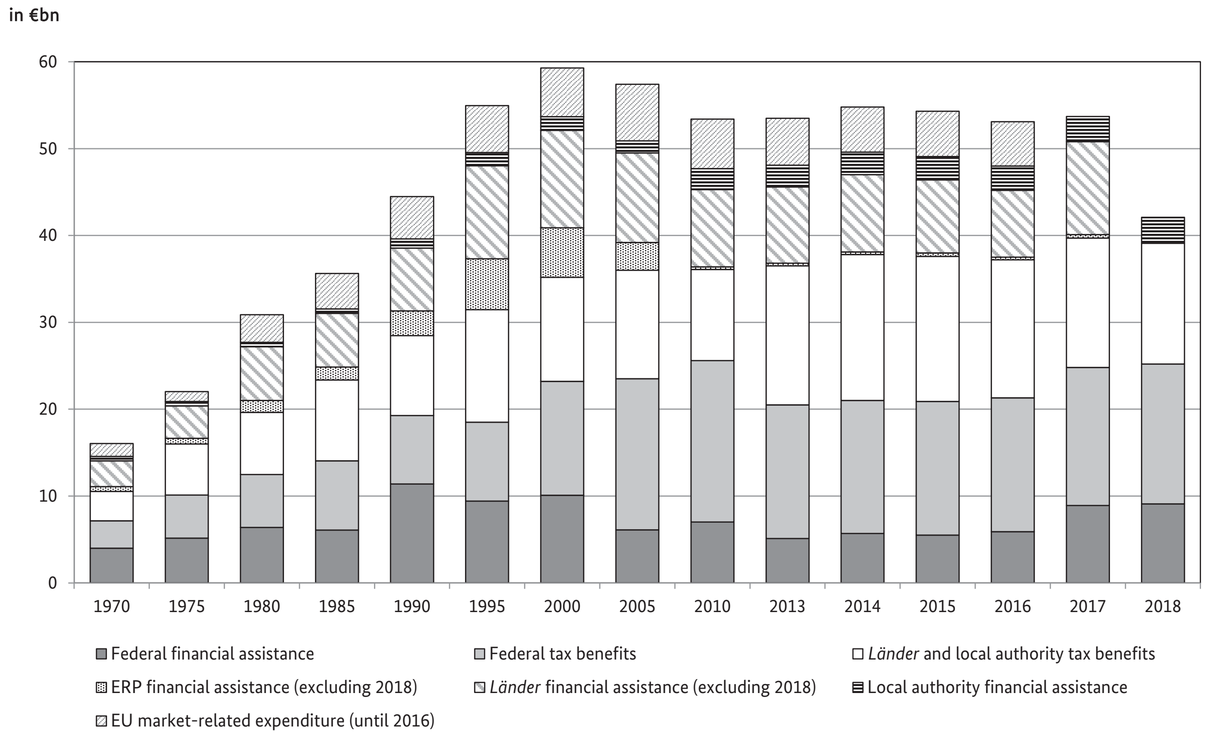
EU market-related expenditure consists of return flows to Germany from the European Agricultural Guidance and Guarantee Fund, Guarantee Section.

Table 5: Reported total volume of federal, *Länder*, municipal, ERP and EU[1)] subsidies (in €bn)

	1970	1975	1980	1985	1990[2)]	1995	2000	2005	2010	2013	2014	2015	2016	2017[7)]	2018[8)]
1. Financial assistance															
Federal	4.0	5.2	6.4	6.1	7.3	9.4	10.1	6.1	7.0	5.1	5.7	5.5	5.9	8.9	9.1
Länder[3)]	3.0	3.7	6.2	6.2	7.2	10.7	11.2	10.3	8.9	8.8	8.9	8.4	7.7	10.7	
Local authorities[4)]	0.5	0.5	0.5	0.5	1.1	1.5	1.6	1.4	2.4	2.5	2.6	2.7	2.8	2.9	3.0
2. Tax benefits															
Federal	3.2	5.0	6.1	8.0	7.9	9.1	13.1	17.4	18.6	15.4	15.3	15.4	15.4	15.9	16.1
Länder and local authorities[5)]	3.4	5.9	7.2	9.3	9.2	12.9	12.0	12.5	10.5	16.0	16.8	16.7	15.9	14.9	13.9
3. ERP financial assistance[6)]	**0.6**	**0.7**	**1.4**	**1.5**	**2.9**	**5.9**	**5.7**	**3.2**	**0.3**	**0.3**	**0.3**	**0.4**	**0.3**	**0.4**	
4. EU market-related expenditure	**1.5**	**1.1**	**3.2**	**4.1**	**4.9**	**5.4**	**5.6**	**6.3**	**5.7**	**5.4**	**5.2**	**5.2**	**5.1**		
Total 1 to 4	**16.1**	**22.0**	**30.9**	**35.6**	**40.3**	**55.0**	**59.4**	**57.2**	**53.4**	**53.5**	**54.8**	**54.3**	**53.1**	**53.7**	**42.1**

1) Former Federal Republic of Germany 1970-1990; Federal Republic of Germany including former German Democratic Republic from 1991.
2) Including financial assistance for former East German *Länder* in supplementary budgets (excluding section B of the third supplement to the 1990 federal budget).
3) Source: Zentrale Datenstelle der Landesfinanzminister (ZDL).
4) Local authority data: estimates based on trends in *Länder* subsidies; source from 2010 onwards: ZDL.
5) The substantial increase since 2013 is the result of temporarily higher volumes due to individuals bringing forward the timing of the transfer of their estate to their heirs by means of gifts, ahead of a Federal Constitutional Court decision (delivered on 17 December 2014) and a pending revision of the rules for inheritance and gift tax.
6) See also table 7. From 2008: Changeover from total loan amount to interest relief granted in connection with applications approved in current year, over total term of loan or of other funding measures.
7) Data on EU market-related expenditure is not yet available for 2017.
8) Data on EU market-related expenditure, ERP financial assistance, *Länder* financial assistance is not yet available for 2018.

Figure 4: Reported total volume of federal, *Länder*, local authority, ERP and EU subsidies, 1970 to 2018



IV. Key general facts, findings and figures

4.1 Legal basis of subsidies

The legal basis for financial assistance consists primarily of rules enacted by the executive branch. This is the case for 58 of the 70 items of financial assistance cited in the current Subsidy Report, although it is also important to take into account contracts that the Federation concludes (e.g. with the KfW development bank) in connection with the implementation of individual programmes. 12 financial assistance items are granted on the basis of statutory provisions. By their very nature, all tax benefits have a statutory basis.

A statutory basis makes the provision of financial benefits more transparent to businesses and private citizens: the criteria for granting subsidies are openly disclosed, and the specific details of the approval process are uniformly regulated and verifiable. This creates legal certainty for private citizens, businesses and the public administration.

At the same time, however, providing subsidies with a statutory foundation generally leads to their perpetuation. Because of the large amount of government and parliamentary effort involved, it is relatively rare for subsidies based on primary legislation to be changed or revised. As a result, such subsidies are more firmly established from the outset. This applies in particular to tax benefits, which all require a basis in primary legislation. In contrast, financial assistance items are largely based on guidelines and can therefore usually be modified more easily. The annual budget preparation process often provides an impetus to modify certain guidelines, for example when a change in resource allocation necessitates adjustments.

Legal basis		**Primary legislation**	**Secondary legislation, guidelines or contract**	**Total**
Financial assistance	Quantity	12	58	70
	%	17.1	82.9	100
	Volume (€bn, 2017)	3.90	4.97	8.87
	%	44.0	56.0	100
Tax benefits	Quantity	104	-	104
	%	100	-	100
	Volume (€bn, 2017)	15.9	-	15.9
	%	100	-	100

In all, 43 of the financial assistance items included in this report – which account for 61.4% of the total – also qualify as state aid under EU law. This shows that the definitions of state aid and subsidies are closely related, but also that the two terms cannot be used synonymously. For example, financial assistance for housing and urban development does not constitute state aid, because it does not affect trade in the internal market.

4.2 Objectives of subsidies

The federal government's subsidy policy guidelines underscore the importance of clear objectives. Clearly defined objectives make it possible to evaluate the success of each measure. The subsidy data sheets (see annexes 7 and 8 of the full Subsidy Report) contain information on the objectives that each subsidy pursues.

In addition, the Act to Promote Economic Stability and Growth stipulates that subsidies are to be classified according to their objective as sectoral support, adjustment assistance or productivity/growth assistance. In addition to these three categories, there are miscellaneous financial assistance items and tax benefits that do not always fit clearly into a specific category.

In 2018, sectoral support is expected to account for only a very small share of total financial assistance, at less than 0.1%. Adjustment assistance, which is expected to account for over 35% of all financial assistance in 2018, is centred on (a) joint Federation/*Länder* tasks to promote regional industry and agriculture and (b) assistance to the coal industry. Financial assistance for purposes such as promoting private sector innovation is classified as productivity and growth assistance. This latter category is expected to account for 9.5% of all financial assistance in 2018. Miscellaneous financial assistance covers subsidies that do not fit clearly into a specific category (projected to rise to 31.3% of total financial assistance in 2018). This category includes such items as funding for measures to promote the use of renewable energy, improve energy efficiency, expand the broadband network and optimise pumping and heating systems. Assistance for private households that indirectly benefits trade and industry is expected to account for 23.7% of all financial assistance in 2018. In particular, such assistance includes funding for energy-efficiency building retrofits and premiums under the Home Ownership Saving Premium Act.

With regard to tax benefits, Table 6 shows only the federal share. Sectoral support will account for the largest portion in 2018 at approximately 48.9%. This includes, for example, energy and electricity tax benefits for manufacturing companies that were introduced as part of ecological tax reform legislation in order to maintain the international competitiveness of the manufacturing sector. Adjustment assistance will make up only a relatively small share of tax benefits in 2018 (2.9%) and includes, in particular, tax allowances and tax exemptions in the areas of trade, industry and agriculture. Productivity and growth assistance, which includes such items as energy duty relief for combined heat and power generation (CHP), is expected to account for 14.8% of tax benefits in 2018. Miscellaneous tax benefits (24.7% of total tax benefits in 2018) include, in particular, reduced rates of value-added tax in various sectors. Tax benefits for private households (8.7% of total tax benefits in 2018) that indirectly assist trade and industry consist mainly of (a) deductions for renovation costs and (b) savings and investment incentives.

Table 6: Federal financial assistance and tax benefits for business enterprises, economic sectors and private households

	2015 Actual[3]		2016 Actual[3]		2017 Budget[3]		2018 Govt. draft[3]	
	€m[1]	%	€m[1]	%	€m[1]	%	€m[1]	%
Financial assistance								
for businesses and economic sectors	4,005	72.3	4,358	73.3	7,006	79.0	6,939	76.3
of which:								
Sectoral support	57	1.0	53	0.9	43	0.5	3	0.0
Adjustment assistance	2,635	47.5	2,780	46.8	3,436	38.7	3,228	35.5
Productivity/growth assistance	596	10.8	610	10.2	799	9.0	860	9.5
Miscellaneous financial assistance	717	13.0	915	15.4	2,728	30.8	2,848	31.3
For private households[2]	1,537	27.7	1,586	26.7	1,862	21.0	2,153	23.7
Total financial assistance	**5,542**	**100**	**5,944**	**100**	**8,868**	**100**	**9,092**	**100**
Tax benefits								
For businesses and economic sectors	14,252	92.5	14,155	92.0	14,524	91.5	14,745	91.3
of which:								
Sectoral support	7,663	49.7	7,596	49.4	7,813	49.2	7,894	48.9
Adjustment assistance	579	3.8	509	3.3	488	3.1	463	2.9
Productivity/growth assistance	2,424	15.7	2,339	15.2	2,365	14.9	2,396	14.8
Miscellaneous tax benefits	3,586	23.3	3,711	24.1	3,858	24.3	3,992	24.7
For private households[2]	1,156	7.5	1,236	8.0	1,356	8.5	1,398	8.7
Total tax benefits	**15,408**	**100**	**15,391**	**100**	**15,880**	**100**	**16,143**	**100**
Federal financial assistance and tax benefits combined								
For businesses and economic sectors	18,257	87.1	18,513	86.8	21,530	87.0	21,684	85.9
of which:								
Sectoral support	7,720	36.8	7,649	35.9	7,856	31.7	7,897	31.3
Adjustment assistance	3,214	15.3	3,289	15.4	3,924	15.9	3,691	14.6
Productivity/growth assistance	3,020	14.4	2,949	13.8	3,164	12.8	3,256	12.9
Miscellaneous financial assistance and tax benefits	4,303	20.5	4,626	21.7	6,586	26.6	6,840	27.1
For private households[2]	2,693	12.9	2,822	13.2	3,218	13.0	3,551	14.1
Overall total	**20,950**	**100**	**21,335**	**100**	**24,748**	**100**	**25,235**	**100**

1) Totals may contain differences due to rounding.
2) Indirectly assist business enterprises and sectors of the economy.
3) Figures for tax benefits are mostly estimated revenue shortfalls. Actual figures are also available in some cases for 2015 and 2016.

4.3 Financial character of assistance

Financial assistance can be provided in the form of grants, loans and debt service assistance, with grants accounting for the predominant share. Loans granted directly from the federal budget have long been of secondary importance. This is partly because in order to provide loans, the federal government uses financial institutes that in most cases receive an interest subsidy to implement the programme concerned. The interest subsidy can be paid either on an ongoing basis – for each annual portion of a loan – or cumulatively for the total amount of assistance approved. The majority of such federal interest subsidies are paid on an ongoing annual basis. Thus the programmes involved – such as KfW loans under the CO2 Building Refurbishment Programme, which can have long approval periods such as 10 years – have a constraining effect on fiscal policy in subsequent years. In some cases, this constraining effect extends beyond the horizon of the federal government's medium-term financial plan. In the year when approval is granted, the federal government enters into a multi-year commitment that leads to corresponding expenditures in subsequent years.

A common feature of tax benefits is that they directly reduce tax revenue. In this way, for example, joint taxes provide joint financing for federal, *Länder* and local authority tasks. Tax benefits that are not subject to a proportionate rate of taxation result in a different subsidy amount for the beneficiary depending on the applicable individual tax rate.

Premiums such as the employee savings premium are paid out in a fixed amount regardless of the applicable tax rate. For the recipient, therefore, a premium has the same effect as financial assistance. With tax benefits there is an ongoing statutory entitlement. Unlike financial assistance, the total subsidy amount is not determined and recorded on the basis of specific budgets.

4.4 Implementation of the subsidy policy guidelines

The subsidy policy guidelines constitute a voluntary commitment by the federal government and are to be taken into account every time a financial assistance item or tax benefit is created or modified. The guidelines state as core priorities that subsidies must be temporary and degressive by design and that they must be subject to evaluations and sustainability impact assessments.

Germany aims to make its public spending more outcome-oriented. Achieving this objective is greatly facilitated by both (a) the regular review of subsidies in terms of their sustainability and cost-effectiveness and (b) the temporary and degressive design of subsidies, which facilitates their reappraisal. The principles enshrined in the subsidy policy guidelines – in particular, defining objectives in a way that makes it possible to measure success and subjecting subsidies to regular evaluation – provide a basis to further improve the outcome orientation of the federal budget, for example by conducting spending reviews.

Furthermore, by commissioning the comprehensive evaluation of 32 tax benefits during the current reporting period, the federal government has underscored its commitment to the resolute implementation of the subsidy policy guidelines, which state that essentially all subsidies are to be subject to regular evaluation in terms of target attainment, efficiency and transparency.

Time limitation

Most financial assistance measures are time-limited. Because most financial assistance is based on guidelines, there tends to be less emphasis on adopting statutory time limits for such assistance. There are also instances in which primary legislation is combined with time-limited secondary legislation. This is the case, for example, with the joint tasks carried out by the Federation and *Länder*: these joint tasks are laid down in general terms in the Basic Law, while the details for each planning period are specified in time-limited planning and coordination frameworks. Because these planning and coordination frameworks make it possible to specify in detail both the object and amount of funding, joint tasks are treated as measures that are time-limited on the basis of secondary legislation. Out of a total of 70 financial assistance items, 46 (65.7%) are time-limited, and 10 of these (14.3%) are in the final funding phase. The latter are measures where the time limitation has already taken effect but there are still funding obligations to be fulfilled. This means that about two-thirds of financial assistance items (or nearly 70% in terms of funding volume) are time-limited. 34.3% of financial assistance items (30.3% in terms of funding volume) are not time-limited. Compared with the previous Subsidy Report, the share of financial assistance items that are not time-limited has been cut from 38.1% to 34.3%. There are various reasons why measures may lack time limits. In some cases, the measures concerned pre-date the adoption of the subsidy policy guidelines and remain in effect unaltered. Other measures are implemented on the basis of annual budget resolutions, without specific guidelines. A small number of measures are based on direct parliamentary mandates, and another small quantity receive European co-financing that is not subject to time limits.

In the case of tax benefits, which always have a statutory basis, a comparatively small number – 21 out of 104 tax benefits – are time-limited. The time-limited tax benefits comprise (a) measures for which time limits were stipulated upon adoption and (b) tax benefits for which a subsequent parliamentary decision was taken to discontinue them because they had outlived their purpose or had been superseded by a follow-up arrangement.

		Total items subject to time limits	Of which: in final funding phase	Annual decision/no time limitation	Total
Financial assistance	Quantity	46	10	24	70
	%	65.7	14.3	34.3	100
	Volume (€m, 2017)	6,182	29	2,687	8,868
	%	69.7	0.3	30.3	100
Tax benefits	Quantity	21	6	83	104
	%	20.2	5.8	79.8	100
	Volume (€m, 2017)	3,837	42	12,043	15,880
	%	24.2	0.3	75.8	100

Degression

Financial assistance is subject to degression in various forms. First, degression can apply for the recipient. This means that assistance granted for multiple years decreases in absolute terms over time. This form of degression aims mainly to prevent recipients from becoming habituated to and dependent upon the subsidy. Second, degression can apply for the subsidising authority. This means that the total outlay for the assistance decreases over time. This objective can also be attained – even if the size of individual grants is held constant or even increased – by restricting the number of grants.

Compared with financial assistance, the scope for applying degression to tax benefits is very limited. Because the criteria for receiving tax benefits are fixed by law, degression can be applied only through statutory limitations of individual amounts on a case-by-case basis.

In the period covered by this Subsidy Report, 19 of the financial assistance items not in the final funding phase feature a degressive structure. These include measures that involve large amounts of financing; as a result, degressive measures account for 42.2% of total subsidy volume. These consist mostly of financial assistance items that are reduced in size by cutting the amount allocated in the budget. Where degression is applied in this way via budget allocation, it is up to the government departments concerned to decide whether the reduction will be implemented by decreasing the number of grants and/or by decreasing the amount of assistance granted in each case.

Evaluation

The federal government's expanded subsidy policy guidelines, which were adopted on 28 January 2015, emphasise that all subsidies should be subject to regular evaluations. For the purpose of subsidy controlling, subsidies are to be reviewed repeatedly in terms of their necessity, expedience and effectiveness (including external effects) as well as their compatibility with the fiscal, economic, social and ecological objectives of the federal government's policies, with a view to their potential for optimisation. Regular and effective internal or external performance evaluations play a decisive role in subsidy policy, not least because they enhance the government's ability to reduce subsidies in a way that is both targeted and economically sound or to optimise how subsidies are designed. These performance evaluations review whether a certain assistance item

		Items with a degressive structure	Items with no degression	Total	Expired (for information purposes)
Financial assistance	Quantity	19	51	70	10
	%	27.1	72.9	100.0	14.3
	Volume (€m, 2017)	3,742	5,126	8,868	29
	%	42.2	57.8	100.0	0.3
Tax benefits	Quantity	3	101	104	6
	%	2.9	97.1	100.0	5.8
	Volume (€m, 2017)	214	15,666	15,880	42
	%	1.3	98.7	100.0	0.3

continues to be necessary and the extent to which it actually fulfils the desired objectives. To do this, it is essential to define clear goals at the time the subsidy is introduced.

Because individual subsidies are structured differently and have different goals, the data sheets on each subsidy (see annexes 7 and 8 of the full Subsidy Report) identify various ways of evaluating a measure's success. These include: verification of the proper use of funds by the responsible departments; outcome analysis and target attainment monitoring based on target–actual comparisons; and comparisons between a reference scenario with a subsidy scenario as part of a macroeconomic simulation. High-quality analyses of outcomes require estimates of how markets would have developed in the absence of state intervention.

The selection of the method to be used in conducting a performance evaluation may also be affected by cost-benefit considerations. In particular, for measures lacking a significant fiscal impact, it is often feasible to conduct only internal evaluations, because the cost of preparing and delivering data for external evaluations can be very high. Similarly, for temporary measures in their final funding phase, it is doubtful whether any potential findings from a performance evaluation will be worth the associated costs. Performance evaluations are conducted internally as well as by the Bundesrechnungshof (Germany's SAI) and external appraisers.

In accordance with the subsidy policy guidelines, the full version of the Subsidy Report contains data sheets on each subsidy, with general information on evaluation cycles, the methodology used, and the findings of evaluations. Evaluation findings provide an indication of the target accuracy and efficiency of each subsidy and can thus aid policy makers when considering whether a subsidy should be retained without modification, modified, reduced or discontinued.

A total of 52 of the 70 financial assistance items – or 74.3% – have been evaluated internally or externally during the reporting period. Overall, 85.9% of total financial assistance has been subject to evaluation. This represents another slight increase (of 0.6 percentage points) over the previous Subsidy Report. 18 financial assistance items were not subject to evaluation, for various reasons: Some are new measures that need to be operating for a certain amount of time before it makes sense to evaluate them. Others are so short-term in nature that evaluations can be conducted – if at all – only after the programme runs out. Still others involve

Evaluations of federal financial assistance and tax benefits		**External**	**Internal**	**No completed evaluation**
Financial assistance	Quantity	34	18	18
	%	48.6	25.7	25.7
	Volume (€m, 2017)	6,793	827	1,248
	%	76.6	9.3	14.1
Tax benefits	Quantity	15	6	83
	%	14.4	5.8	79.8
	Volume (€m, 2017)	7,399	36	8,445
	%	46.6	0.2	53.2

measures which have already expired but still hold residual funding and for which no further evaluations are planned. Non-evaluated financial assistance items will account for 14.1% of total financial assistance in 2017. For the most part, financial assistance items that involve large amounts of funding are evaluated externally. Financial assistance items evaluated externally will account for 76.6% of total financial assistance in 2017, up from 70.4% in the previous Subsidy Report.

External evaluations are performed by a wide range of experts. Internal evaluations are mostly conducted at shorter intervals. The evaluations draw on expert knowledge from across the public administration. This process must be continued to arrive at more uniform standards for both internal and external evaluations.

Along with evaluations of financial assistance items, there is a particular need to evaluate tax benefits. In the future, tax benefits are to be evaluated at regular intervals. The plan here is, during each evaluation round, to review a set of tax benefits that (a) have major fiscal impacts and (b) have yet to be evaluated externally or have not been evaluated externally in the past 10 years. As part of its work to implement the expanded subsidy policy guidelines, the Federal Ministry of Finance commissioned an extensive research project in March 2017 that will evaluate the largest tax benefits that have not yet been subject to external evaluation. This means that an additional 32 tax benefits listed in Annex 2 of the 25th Subsidy Report are currently undergoing evaluation.

Of the 104 tax benefits granted during the current reporting period, external evaluations have been completed for 15 (14.4%), and internal evaluations have been completed for 6 (5.8%). A priority is placed on evaluating tax benefits with major fiscal impacts. As a result, federal tax benefits for which an evaluation has already been completed currently account for 46.8% of all federal tax subsidies. The ongoing evaluation of 32 additional tax benefits listed in the 25th Subsidy Report will significantly increase the number of measures that have been subject to external evaluation. This means that, based on revenue estimates for the year 2017, approximately 85% of federal tax subsidies will have been evaluated.

Sustainability impact assessment

Under the expanded subsidy policy guidelines, sustainability impact assessments are to be conducted on all subsidies. These are carried out by the ministry with lead policy responsibility for each particular subsidy. Sustainability is a guiding principle of federal government policy and is targeted towards the achievement of intergenerational equity, social cohesion, quality of life, and the acceptance of international responsibility. Accordingly, (a) the performance of the economy, (b) the protection of natural resources and (c) social responsibility are to be combined in a way that ensures the long-term sustainability of future developments.

Sustainability impact assessments are based on the 2016 update of Germany's national sustainability strategy, which was approved by the federal cabinet on 11 January 2017. The update constitutes the most comprehensive version of the national sustainability strategy since it was first adopted in 2002. The strategy is increasingly international in its orientation and is geared in particular towards the Sustainable Development Goals (SDGs) contained in the 2030 Agenda for Sustainable Development adopted by the United Nations. The updated German strategy sets national targets for all 17 SDGs and specifies at least one indicator-based national policy goal for each SDG. It also improves and refines the rules for sustainability management. With these updates, the national sustainability strategy now provides the framework for implementing the 2030 Agenda in Germany.

In line with the national sustainability strategy, sustainability impact assessments for subsidies examine the extent to which a particular subsidy affects the strategy's specified targets and management rules. The assessments analyse the long-term economic, environmental and social impacts of the subsidy in question, i.e. how the subsidy will affect such things as economic prosperity, financial security, climate protection, resource conservation and job creation/retention. By aligning its system of targets and indicators with the UN's sustainability goals, Germany is making sure that its policies also place a stronger focus on important international targets involving global supply and value chains, such as promoting decent work and economic growth (SDG 8) and ensuring sustainable consumption and production patterns (SDG 12). This means in addition that the sustainability impact assessments enshrined in Germany's subsidy policy guidelines meet the specifications laid down in the UN's Guiding Principles on Business and Human Rights.

Subsidies affect the national sustainability strategy's targets and impacts in different ways and must therefore be assessed in a manner that takes these differences into account. Most financial assistance items and tax benefits are related directly or indirectly to the national sustainability strategy's objectives and management rules. However, subsidies also give rise to the increased consumption of financial, material and/or natural resources and, to this extent, can lead to conflicts with other objectives enshrined in the strategy such as resource conservation, climate protection and government debt reduction. Such adverse impacts on other government objectives and the resulting conflicts are one of the reasons why subsidies always require justification.

Because they are geared towards (a) targets and indicators derived from the 17 SDGs and (b) the national sustainability strategy's management rules, sustainability impact assessments place a central focus on examining the outcomes of measures from various perspectives. This means that a coherent subsidy policy aligned with Germany's sustainability strategy must be attentive to potentially conflicting objectives.

The 11 newly introduced financial assistance items, which are included as subsidies in this report, will have a largely positive impact on the targets and indicators contained in Germany's sustainability strategy. Five of these items are targeted towards environmental outcomes such as the promotion of climate protection, resource conservation and renewable energy use. These items support Germany's clean energy transition and include programmes and measures that focus on renewable energy; electricity and power grids; digitisation and energy infrastructure; the optimisation of pumping and heating systems; and subsidies for the purchase of electric cars. Five other financial assistance items (such as support for the film industry and funding for innovative port technology) focus on economic outcomes, particularly in terms of economic output, innovation and provision for future economic stability. The new assistance items for agricultural businesses, which were introduced in response to market crises, aim primarily to ensure social sustainability. Three newly introduced tax benefits place a priority on economic outcomes.

Subsidies that have already been in place for a longer period of time should, as part of the evaluation process, be regularly reviewed in terms of their conformity with the rules of the national sustainability strategy. Thus sustainability impact assessments form part of the tax benefit evaluations that are currently being conducted. Other subsidies, especially those that target sectoral support, are to be assessed mainly in an international context. For example, a number of energy duty benefits do not have an immediate positive environmental impact in Germany but are justified in economic and environmental terms to the extent that they prevent production from being shifted to countries outside of the EU that have significantly lower environmental protection and energy standards. Justifications of subsidies based solely on indirect outcomes require a particularly strong rationale and should likewise be reviewed at regular intervals.

Sustainability impact assessments are based primarily on qualitative measurements, because it is nearly impossible at present to make reliable statements about the quantitative impacts that subsidies have on the national sustainability strategy's complex system of targets and indicators.

V. Summary

The federal budget has required no new borrowing since 2014. The fiscal space resulting from Germany's successful consolidation policies is now being used to boost targeted pro-growth investment in priority policy areas and to provide tax relief. This boosts Germany's competitiveness, makes our country more fit for the future, and reinforces consumer and business confidence that the economy will continue to develop in a stable manner.

Federal subsidies, in the form of financial assistance and tax benefits, are set to climb from €20.9 billion in 2015 to €25.2 billion in 2018. This €4.3 billion growth is being driven primarily by an increase in financial assistance items targeted towards priority policy areas. A total of 11 new financial assistance items have been introduced. Financial assistance items will increase by just under €3.6 billion during the reporting period, and the amounts budgeted for 2017 are €3.0 billion higher than the amount spent in 2016. Much of this increase is based on 2016 budget appropriations that boosted forward-looking federal investment in broadband network expansion, energy-efficient building refurbishment, and overall energy efficiency. The new financial assistance items include funding to optimise pumping and heating systems as well as subsidies for the purchase of electric cars. Federal tax benefits are projected to rise from €15.4 billion in 2015 to €16.1 billion in 2018.

Given the strong performance of the economy and solid rates of GDP growth, the federal subsidy ratio remained constant at 0.7% in 2016 despite the introduction of new subsidies and an increase in funding for certain existing subsidies. This means that the subsidy ratio has remained basically steady at a low level in recent years. As federal tax revenue continues to trend upwards, federal tax benefits will decline during the current reporting period to their lowest level relative to federal tax revenue since the mid-1990s. An increase in financial assistance – as indicated by the target spending amounts for 2017 and 2018 – could cause the subsidy ratio to rise slightly to 0.8% of GDP in both of these years.

In line with the subsidy policy guidelines, all of the new financial assistance items being introduced during the current reporting period to promote priority measures targeting climate protection, broadband expansion, electric vehicles and digital technology will be provided on a temporary basis. Most of the individual measures take the form of adjustment assistance or productivity assistance, with the aim of promoting (a) productivity and growth or (b) structural adjustment in sectors that hold particular significance for Germany's economic future.

It is important for subsidies to fulfil their purposes in a manner that is both effective and cost-efficient. For this reason, it is crucial to have an effective performance evaluation system in place. Germany's subsidy policy guidelines state that all subsidies granted by the federal government must be evaluated on a regular basis, particularly in terms of target accuracy, efficiency and sustainability. Such evaluations seek in particular to prevent the misallocation of resources and to identify potential for optimisation.

The subsidy policy guidelines set the ground rules for the federal government's subsidy policy. They ensure transparency, reinforce accountability, and improve governance with a view towards facilitating the effective management and controlling of subsidies. By commissioning the systematic evaluation of 32 additional tax benefits listed in Annex 2 of the 25th Subsidy Report, the federal government has underscored its commitment to the resolute implementation of the guidelines.

In addition, since the publication of the 25th Subsidy Report in 2015, a sustainability impact assessment is being conducted for every individual measure. Sustainability impact assessments broaden the spectrum of subsidy management instruments. They aim to make holistic appraisals of subsidies by weighing the outcomes of individual measures from a variety of sustainability-related perspectives.

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