Economic analysis from the European Commission's Directorate-General for Economic and Financial Affairs

Volume 5, Issue 12

28.11.2008

ECFIN COUNTRY FOCUS

***Highlights in this issue:***

- **Lack of efficient expenditure and budget rules contributed considerably to the deterioration of German public finances until 2006**
- **Promising proposals for a new budget rule are on the table**
- **Unique political momentum to agree on Federalism Reform II**

# Germany: revisiting the budget rule

*By Carsten Eppendorfer and Karolina Leib**

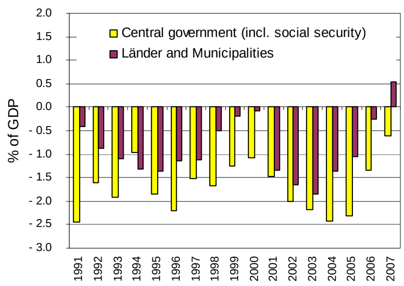
***Summary***

*Prior to a recovery in 2007 and 2008, Germany's public finances had deteriorated substantially since reunification. The lack of efficient expenditure and budget rules was a crucial factor in this development. To limit future debt, proposals for a new budget rule are currently being discussed in the context of the second stage of the Reform of Federal Fiscal Relations (Föderalismusreform II). The various proposals put forward by the government authorities, major parties and political and economic institutions show a tendency to favour a close-to-balance rule which would be compatible with the European Stability and Growth Pact and would constitute a major improvement on the current rule. Conceptual differences at the Länder and Bund-Länder level appear to be reconcilable. However, they need to be resolved rapidly to capitalise on the current political momentum to pass the necessary constitutional amendments.*

## *On the need for a national stability pact*

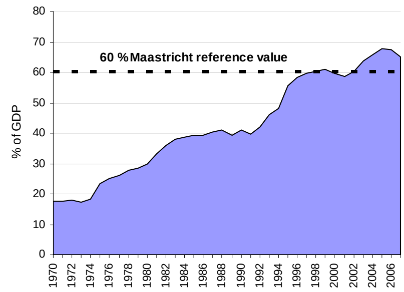
Public finances in Germany deteriorated considerably after reunification[1] and only in the past two years the deficit has been corrected. Under the rules of the European Stability and Growth Pact (SGP), Germany was subject to the excessive deficit procedure (EDP) for four years in a row from January 2003 to June 2007, breaching the 3%-of-GDP ceiling for the general government fiscal deficit (Chart 1). While public debt was still at 39.5% of GDP in 1991, it amounted to 65% in 2007, down from a peak of 67.8% in 2005. Since 2002, it has continuously exceeded the SGP reference value for the general government debt of 60%-of-GDP (Chart 2).

**Chart 1: Fiscal balances**




*Source*: Commission Services

**Chart 2: General government debt**




*Source*: German Federal Ministry of Finance

*** Directorate for the Economies of the Member States.**

Three main factors contributed to the structural deterioration of German public finances: higher uncertainty due to an increased volatility of revenue elasticity, the lack of expenditure limits and an ineffective budget rule.

*Increased revenue volatility requires prudent medium-term budgetary planning*

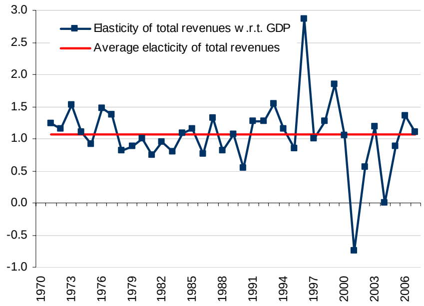
Firstly, on the revenue side, an increased volatility in revenue elasticity complicated budgetary planning after reunification (Chart 3). This was mainly driven by tax composition effects, i.e. the fact that different tax bases do not develop in parallel during different phases of a business cycle. Also discretionary policy measures (e.g. reduction of income tax rates in 1999-2005) added to volatility, as their budgetary impact was often difficult to estimate *ex ante* and they did not always have (the intended) counter-cyclical effect.[2] As the link between economic activity and major government revenue components has become less stable, short-term revenue forecasts can only be made with a higher margin of error.[3] As on the expenditure side, such uncertainty would call for more prudent medium-term budgetary planning.

*No shared responsibility between government levels for the commitments within the SGP*

*Lack of expenditure ceilings and sanction mechanism*

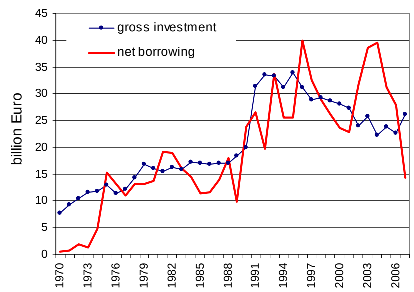
Secondly, the expenditure side lacks binding ceilings and sanction mechanisms. The German Constitution grants full autonomy to the budgetary authorities at the federal and *Länder* level.[4] Since the beginning of the 1980s, the Fiscal Planning Council (*Finanzplanungsrat*) had been providing annual recommendations for the (nominal) expenditure growth rate for the current year and the following four years. A first step towards expenditure coordination between federal and State level was made in 2002, when the Law on Budgetary Principles (*Haushaltsgrundsätzegesetz*) was amended, stressing the common responsibility of both levels for complying with the commitments made by Germany within the SGP framework[5]. The key objective was to weaken the incentive to free-ride on budgetary consolidation, with only the federal government - while accounting for less then 20 percent of total expenditure[6] - being fully responsible for meeting SGP criteria at the EU level[7]. Since then, the *Finanzplanungsrat* began to issue biennial recommendations on the consolidated expenditure lines for the governments at the federal and *Länder* levels (including local authorities). While this was an institutional improvement, expenditure targets were still violated frequently, given their imprecise definition, opaque monitoring and the lack of a sanctioning device. Furthermore, the largely short-term orientation of expenditure targets favoured pro-cyclical behaviour which ran against the SGP objective to let the automatic stabilisers operate in a symmetric way.[8]

**Chart 3: Revenue elasticity**




*Source*: Commission Services

**Chart 4: Net borrowing and gross investment of the federal government (cash statistics)**




*Source:* German Federal Ministry of Finance

*German budget rule turned out to be ineffective*

Thirdly, the current German budget rule suffers from certain inherent shortcomings[9]. The rule laid down in Article 115 of the German Constitution limits net borrowing to the amount of *gross* public investment, except in the case of a *disturbance of the macroeconomic equilibrium*. However, this exception clause is not clearly defined.[10] The legislator has a scope for judgmental evaluation which is to be based on economic reasoning, and needs to be backed by the recommendations of the institutions in charge of the economic analysis[11]. Moreover, the investment rule does not take into account depreciation of the public capital stock[12]. Thus, the limit set for new borrowing leaves considerable discretionary leeway. Furthermore, the rule does not operate symmetrically over the business cycle, i.e. while in the cases of a *disturbance of the macroeconomic equilibrium* net borrowing is unlimited, there is no obligation for counterbalancing in economic "good times". In addition, there are no sanctions when the rule is violated. From an EU perspective, the rule turned out to be "SGP-incompatible" most of the time. It could neither prevent excessive deficits in 2002-2005 nor the accumulation of general government debt - since 1970 the rule was breached in almost half of the years (Chart 4). Finally, many of these shortcomings apply also at the *Länder* level, as twelve out of sixteen German *Länder* transposed the federal rule into their constitutions.

Against this background, the Ecofin Council had repeatedly invited the German authorities to agree on a "national stability pact" in order to make the attainment of the medium term objective (MTO) within the SGP framework more credible[13]. Also, the Federal Constitutional Court, in its ruling of 9th July 2007, urged the government to provide a more effective debt limit[14]. In response to that, Germany undertook first steps to formulate a new budget rule and create a framework involving all government levels in fiscal consolidation. The future limitation of new indebtedness is a central goal of the ongoing second stage of the Federalism Reform (*Föderalismusreform II*), whereby the key task of the "Commission on the Modernisation of Federation-*Länder* Financial Relations", appointed in March 2007, is to propose a more effective budget rule that is binding for both the *Bund* and the *Länder*.

## *A new budget rule: is reconciliation possible?*

*Various proposals for a new budget rule on the table*

Similarly to the heated debate on the reform of the SGP[15], the ongoing discussion on the new budgetary rule for Germany is fuelled by a plethora of proposals. This Country Focus screens various models put forward by the government authorities, major parliamentary parties and political and economic institutions (Table 1) and discusses the emerging *consensus rule* from the EU perspective. The abundance of proposals points to a strong political will to change the existing rule. However, even though the models seem to follow similar principles, they differ with respect to crucial points.

**Table 1: Overview of proposed budget rules**

| Features | | | Proposals |
|---|---|---|---|
| **Effective limit for structural borrowing of the general government** | Not specified | | Struck & Oettinger (2008), Bündnis 90/Die Grünen (2007) |
| | No structural deficit | | CDU/CSU (2008), FDP (2008) [1] |
| | 0.5% of GDP | | BMF (2008) |
| | 0.75 % of GDP | | SPD (2008) |
| **Net investment rule** | | | Deubel (2007), EEC (2007), Bündnis90/Die Grünen (2007) |
| **Borrowing rule** | New borrowing < 5% of total expenditure (~ 0.5% of GDP) | | AAC at the BMWi (2008) |
| **Stabilisation over the business cycle** | Structural balanced budget over a period (e.g. cycle) | | Struck & Oettinger (2008) |
| | New borrowing in downswings, limited borrowing or surpluses in upswings[2] | | BMF (2008), CDU/CSU (2008), SPD (2008), |
| | New borrowing in downswings, surpluses in upswings | | Deubel (2007), EEC (2007), Bündnis90/Die Grünen (2007) |
| | New borrowing in downswings, fluctuation reserves | | AAC at the BMWI (2008) |
| **Enforcement mechanism** | Not specified | | FDP (2008) |
| | Adjustment account | Not specified | SPD (2008) |
| | | 1% of GDP | CDU/CSU (2008) |
| | | 1-2% of GDP | BMF (2008) |
| | | 2 % of GDP | EEC (2007) |
| | Stability Council | | Struck & Oettinger (2008), BMF (2008), SPD (2008), Deubel (2007), Bündnis90/Die Grünen (2007) |
| | Repayment plan | | CDU/CSU (2008), Bündnis90/Die Grünen (2007) |
| | Time limit for credit repayment | | AAC at the BMWI (2008), Bündnis90/Die Grünen (2007) |
| **Sanctions** | Not specified | | Struck & Oettinger (2008), BMF (2008), Deubel (2007), AAC at the BMWI (2008) |
| | To be specified by a Stability Council | | SPD (2008), Bündnis90/Die Grünen (2007) |
| | Gradual sanctions | | CDU/CSU (2008)[3], EEC (2007)[4], FDP (2008) |
| **Exception clauses** | Not specified | | Struck & Oettinger (2008), Deubel (2007) |
| | 2/3 majority in *Bundestag* | | Bündnis 90/Die Grünen (2007), FDP (2008) |
| | 3/5 or 2/3 majority in *Bundestag* | | BMF (2008), CDU/CSU (2008), SPD (2008) [5] |
| | 2/3 majority in *Bundestag* + 2/3 majority in *Bundesrat* | | EEC (2007)[6] |
| | 3/5 majority in *Bundestag* | | AAC at the BMWI (2008)[7] |
| **Federal aspects** | Not specified | | AAC at the BMWI (2008) |
| | Differentiated transition periods | | Struck & Oettinger (2008), BMF (2008), CDU/CSU (2008), Bündnis90/Die Grünen (2007) |
| | *Stabilisierungsfonds* | | Deubel (2007) |
| | Transposition of the rule to the Länder level | | EEC (2007) |
| | Federal aid to the poorer states | | Struck &Oettinger (2008) [8], Bündnis90/Die Grünen (2007) |

Source: Commission Services

Notes: [1] Proposes additional credits (*Kassenverstärkungskredite*) of max. 10% of current budget; [2]Commission's methodology; [3] Budget autonomy temporary limited, obligatory budget amendments, obligatory proposal for budget consolidation, automatic increases in revenues (or reduced expenditure); [4] Obligatory budget amendments, automatic tax surcharges; [5]Major unexpected cases (e.g. terrorist attacks, etc); [6]Cases of nature disasters, otherwise governing majority suffices; [7]For credits less than 5% of expenditure simple majority in the *Bundestag* suffices; [8]Debt service fund to help poorer *Länder* to pay their interests

Abbreviations: Academic Advisory Council at the BMWI (AAC), German Council of Economic Experts (EEC), Federal Ministry of Finance (BMF), Federal Ministry of Economics (BMWI), Christian Democratic Union (CDU), Christian Social Union (CSU), Free Democratic Party (FDP), Social Democratic Party of Germany (SPD)

*New budget rule to be in line with the European framework*

The core element of most proposals is a structural deficit ceiling geared to the medium-term objective (MTO) of 0-0.5% of GDP for Germany in the framework of the SGP[16] and endorsed by the Ecofin Council. At the upper end, a deficit ceiling of 0.75% of GDP, as envisaged by the SPD, is less strict than the current MTO. The 0.0% of GDP put forward by the CDU/CSU and by the FDP marks the other end of the range. Although in line with the MTO, this proposal incurs the risk of suppressing the fiscal flexibility. Therefore, a deficit of 0.5% of GDP proposed by the German Ministry of Finance (BMF) may be seen as a political compromise. In any case, none of the proposed deficit ceilings seems to be anchored in a comprehensive analysis taking into account demographic aspects and scrutinising available policy solutions to close the sustainability gap, e.g. the degree of frontloading of the future social security costs or additional pension reforms.

Moreover, the MTO can be revised, as in principle it should be designed in a flexible manner, so that there is enough room for manoeuvre when the social security legislation changes or ageing cost projections are revised.[17] In addition, the MTO could take into account public investments[18]. This could require budgetary targets to be changed. Therefore, the formulation of the rule in the constitution should offer sufficient flexibility to adjust the deficit ceilings. In any case, a limit for the general government deficit of 0-0.5% of GDP in structural terms would be tighter than the current criterion of gross investment.

Most of the proposals provide for a rule to be applied symmetrically over the business cycle and recognise the need to limit structural borrowing or build up surpluses in economically good times. This is in line with the SGP requirement to let the automatic stabilisers operate fully. Regarding structural deficit calculations, it would be important to ensure a transparent communication, on which phase of the cycle the economy finds itself in. On the technical side, the use of the SGP methodology and statistical delimitation (system of national accounts), as suggested by some of the proposals, would be a major progress from the EU point of view.

*Adjustment account: a symmetrical rule over the cycle*

Three proposals (by the German Council of Economic Experts (EEC), Federal Ministry of Finance (BMF)[19] and CDU/CSU) foresee an adjustment account (*Ausgleichkonto*) to record the structural deviations from the authorised deficit level, with the overruns booked as debit, and underruns recorded as credit. The account would have a debit ceiling (e.g. 1-2% of GDP) and a clear agenda for the adjustment path in cases of an "overdraft". The debit ceiling is to reflect unforeseen demand for credit, e.g. due to fluctuations in revenue elasticity or miscalculation of the budgetary impact of policy measures. The incentive of strategic miscalculation of the budget (e.g. by strategic forecasting of potential output or output gap) is limited as the *ex post* budgetary position as well as the actual economic development is taken as a reference for the bookings on the adjustment account. However, only the implementation of a clearly defined sanction mechanism could ensure the application of the adjustment account in a credible manner.

If accepted at the national level, such a mechanism would in principle lead to a stricter adjustment rule than the one laid down in the SGP (i.e. an annual structural adjustment of 0.5% of GDP to reach the MTO[20]). Contrary to the SGP, the adjustment account would allow for past deviations to be taken into account ("memory function"), which would also allow previous increases in the debt-to-GDP ratio due to excessive deficits to be corrected (Box). Furthermore, the model of the adjustment account seems to be reconcilable with weaker forms of enforcement like the establishment of a Stability Council, time limits for credit repayment or obligatory repayment plans.

The SPD and the Bündnis90/Die Grünen would entrust a Stability Council with the specification of possible sanctions. However, there are doubts whether a Council would be able to impose and execute sanctions on individual *Länder* or the Federal Government, which appear necessary to achieve effective compliance with the rule. Considering Germany's experience with the systematic violation of the current budget rule, it is surprising that only three proposals (CDU/CSU, EEC and FDP) feature some sort of gradual sanctioning device. In that context, all proposals envisage exception clauses (e.g. for natural disasters, etc.), whereby the decision on additional borrowing must be passed with a qualified majority of the *Bundestag*.

**Box: SGP vs. adjustment account in practice**[1), 2)]

| Year | Structural position: Ex ante: According to SGP | Structural position: Ex ante: According to national authorities | Structural position: Ex post | Adjustment path: According to SGP | Adjustment path: According to national authorities | Adjustment account |
|---|---|---|---|---|---|---|
| **t=0** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **t=1** | 0.0 | 0.0 | -0.5 | +0.5 | +0.5 | -0.5 |
| **t=2** | 0.0 | 0.0 | -0.5 | +0.5 | +0.5 | -1.0 |
| **t=3** | 0.0 | 0.0 | -0.5 | +0.5 | +0.5 | **-1.5** |
| **t=4 a** | **0.0** | **0.5** | **0.5** | - | - | **-1.0** |
| **t=4 b** | **0.0** | **0.5** | **0.0** | - | **+0.5**[3)] | **-1.5** |

Source: Commission Services. Notes: [1)] Abstracting from the problems of forecast versus realised GDP growth and related corrections of the cyclical component in the calculation of the structural positions, [2)] Assuming that there are no differences between planned and realised balance of financial transactions. [3)] Gradual adjustment could be also possible, e.g. obligation to reduce the 50% of the excessive sum in the following year.

This stylised example serves to illustrate the "memory mechanism" of the adjustment account. For simplicity, the national MTO for Germany is assumed to be 0.0% of GDP. Assume further that the national structural deficit ceiling is set at 0.0% of GDP and the debit ceiling of the adjustment account is 1% of GDP. The adjustment account is debited (credited) *only* with the *structural* overruns (underruns) of the deficit ceiling. Thus, the adjustment account does not allow for the *cyclical* deviations from the deficit ceiling which reflect the automatic stabilisers operating in a symmetric way. The cyclical deviations are assumed to be balanced over the cycle.

Starting with a balanced budget and adjustment account in t=0, the MTO is missed by 0.5% of GDP for three years in a row. According to the SGP and the national adjustment path, the structural position needs to be corrected each year by 0.5%. At t=3 the adjustment account would be debited with 1.5% of GDP, which is above the debit ceiling. Therefore, at t=4, the account would have to be credited with the real savings. This requires national authorities to achieve a structural surplus of 0.5% of GDP at t=4 (reflected in their *ex ante* budgetary planning). Compared to the SGP, at t=4 the adjustment account would oblige the national authorities to follow a stricter consolidation path. Importantly, the credits recorded on the adjustment account cannot compensate for the deficit of the current budget, as they are not real savings but just an under-usage of allowed net borrowing.

Regarding the implementation of the new rule within the framework of federal fiscal relations, except for Deubel and the EEC, no comprehensive solutions are put forward to incorporate the *Länder* level. There is a number of open questions in this respect. Firstly, how should the *Länder* divide the share of the structural deficit limit designated to them? Secondly, how will they best be able to achieve their respective stability contributions: by copying the new rule or by formulating individual solutions tailored to their differentiated needs?[21] Thirdly, how to design an enforcement mechanism to provide incentives for good budgetary performance? One possibility would be a peer pressure process, similar to the one applied in the SGP context at the EU level, which could be reinforced by a sanctioning system to penalise the violation of the rule. Finally, how to treat the *Länder* that have disadvantaged fiscal starting positions with respect to accumulated debt? Currently, most of the models do not specify any *Länder* options, but agree that differentiated transition periods will be needed. In addition, two further concepts envisage special debt service funds to help poorer Länder to meet their interest payments obligations[22].

*Three arenas of political debate*

Altogether, there seems to be an agreement on the need for a numerical ceiling on the structural deficit with the ownership shared between the *Bund* and the *Länder*, on a symmetrical operation of the rule over the business cycle as well as on the necessity of an enforcement mechanism, sanctions and exception clauses. Most of the proposals agree also that differentiated transition periods for the *Länder* will be needed to take into account their different fiscal starting positions. All in all, a tendency is emerging in the direction of a *close-to-balance rule* rather than a *net investment rule*[23]. However, three major differences exist. These concern the actual limit of the structural deficit; the form of the rule at the *Länder* level; and the question of financial aid to the *Länder* with poor starting fiscal positions, i.e. with high debt levels. These issues intertwine and enter the political debate at three points: at the federal level, where the political parties seek an agreement on the numerical ceiling for the structural deficit; at the *Länder* level, where the "poor" and "rich" states argue about the *Länder*-specific rules and the solutions for the highly indebted *Länder* ; and at the cross-section between the interests of the *Bund* and the *Länder*, where all the issues are subject to debate between the interested parties (e.g. the split of the borrowing ceiling between the *Bund* and the *Länder*).

## *Conclusions*

The lack of effective expenditure and budget rules seems to have contributed substantially to the deterioration of Germany's public finances in the last two decades. The remarkable budgetary consolidation of 2007 and 2008 was to a large extent driven by the unexpectedly high tax revenues used for deficit reduction. In addition, the massive increase in the VAT rate in 2008 was only partly offset by lower social contributions. The expenditure-based consolidation was greatly aided by the higher-than-expected savings in the labour market expenditure.

Suffering from numerous shortcomings, the current German budget rule in particular was not able to prevent either the excessive deficits in 2002-2005or the accumulation of general government debt. This calls into question its compatibility with the SGP framework. The central goal of the ongoing second stage of the Federalism Reform is therefore to enact a more effective budget rule.

The abundance of proposals points to a firm political will to change the current rule. The existing differences at different layers of government (*Länder*/*Bund)* appear to be reconcilable. However, they need to be resolved relatively quickly to make use of the present window of opportunity under a Grand Coalition that enables the necessary constitutional amendments to be passed.

From an EU perspective, the compatibility of a new rule with the SGP would be desirable. Our analysis suggests that the main proposals considered seem to be in line with the SGP requirements. The emerging consensus is a *close-to-balance rule* that follows the SGP structure in the sense that it includes a national structural deficit ceiling à la MTO (*preventive arm*) and proposes an adjustment account. The latter would allow for the correction of the past deviations from the target – a feature absent in the SGP.

However, defining the "correct" national structural deficit ceiling in the Constitution is difficult in practice due to problems arising from the necessary adjustments to changes in the social security system and revisions of the projected ageing cost. Such adjustments could mean a need for higher budgetary targets. Therefore, the formulation of the rule in the constitution should offer sufficient flexibility to fine-tune the deficit ceilings if necessary. Another challenge emerges regarding the "adequate" limit on the adjustment account, which is important in the context of the risk of a potential pro-cyclical impact of the rule during downswings.

All in all, the proposals put forward constitute clear improvements from the current budgetary rule. However, the lack of concrete sanction mechanisms jeopardises the effectiveness of any budget rule and modest attempts to work out *Länder*-specific solutions undermine the *ex ante* sustainability of a new national stability pact.

## *References*


**Baumann, E. and C. Kastrop, (2008)**, "A New Budget Rule for Germany", in Fiscal Policy: Current Issues and Challenges, Banca d'Italia, Research Department, Public Finance Workshop 2008

**Bundesverfassungsgericht (1989)**, "Kreditobergrenzen gem. Art.115 I GG", BVerfGE 79, 311

**Council of the European Union (2000 a)**, Council opinion of 28 February 2000 on the updated stability programme of Germany for the period 1999 to 2003

**Council of the European Union (2000 b)**, Council opinion of 27 November 2000 on the updated stability programme of Germany for the period 2000 to 2004

**European Commission (2003)**, "Public Finances in the EMU-2003", *European Economy*, No. 3

**European Commission (2006)**, "Public Finances in the EMU-2006", *European Economy*, No. 3

**European Commission (2007)**, "Public Finances in the EMU-2007", *European Economy*, No. 3

**European Commission (2008)**, "Germany: Macro Fiscal Assessment – An Analysis of the December 2007 Update of the Stability Programme"

**Fischer, J., Jonung, L. and M. Larch (2008)**, "101 Proposals to reform the Stability and Growth Pact. Why so Many? A Survey", Public Finance and Management, Vol. 8, No. 3, pp. 502-560

**Groneck, M. and R. C. Plachta (2008a)**, "Teilentschuldung nur mit sanktionsbewehrter Regel", ifo Schnelldienst, No. 9, pp.10-14

**Groneck, M. and R. C. Plachta (2008b)**, "Close-to-balance oder Nettoinvestitionen? – Kreditgrenzen für Bundesländer", Wirtschaftsdienst 88(2), pp.115-120

**Janeba, E. (2008)**, "Regeln zur Begrenzung von Staatsverschuldung: Welche Rolle für den politischen Bürger?", ifo Schnelldienst, No. 9, pp. 7-10

**Kastrop, C. and M. Snelting (2008)**, "Das Modell des Bundesfinanzministerium für eine neue Schuldenregel", *Wirtschaftsdienst*, No. 6, pp. 375-382

**Kommission von Bundestag und Bundesrat zur Modernisierung der Bund-Länder-Finanzbeziehungen**: Beschluss der CDU/CSU–

Bundestagfraktion vom 11. 03. 2008, "Schuldenbremse für Deutschland", Kommissionsdrucksache 097

**Kommission von Bundestag und Bundesrat zur Modernisierung der Bund-Länder-Finanzbeziehungen** Deubel. I. (2007), "Der Stabilisierungsfonds: Ausgleich konjunktureller Schwankungen, Abbau struktureller Defizite und Bewältigung von Haushaltskrisen", Kommissionsdrucksache 056

**Kommission von Bundestag und Bundesrat zur Modernisierung der Bund-Länder-Finanzbeziehungen** "Eckpunkte zur Modernisierung der Bund-Länder-Finanzbeziehungen. Vorschlag der Vorsitzenden FV Dr. P. Struck MdB, MP G.H. Oettinger MdL", Berlin, 23.06.2008

**Kommission von Bundestag und Bundesrat zur Modernisierung der Bund-Länder-Finanzbeziehungen** FDP-Bundesfraktion, "Ausstieg aus dem Schuldenstaat – Einstieg in mehr Generationsgerechtigkeit", Kommissionsdrucksache 094

**Kommission von Bundestag und Bundesrat zur Modernisierung der Bund-Länder-Finanzbeziehungen** Vorschlag der Bund-Länder-Arbeitgruppe Bündnis90/ Die Grünen, "Schuldenbremse und solidarische Entschuldung", Kommissionsdrucksache 095

**Kommission von Bundestag und Bundesrat zur Modernisierung der Bund-Länder-Finanzbeziehungen** Föderalismusreform II - Beschluss der SPD-Bundestagfraktion vom Juli 2008, Kommissionsdrucksache 127

**Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung (2007)**, "Staatsverschuldung wirksam begrenzen", Expertise im Auftrag des Bundesministeriums für Wirtschaft und Technologie

**Wissenschaftlicher Beirat beim Bundesministerium der Finanzen (2007)**, "Schuldenbremse für Bund und Länder – Für eine Neufassung der Verschuldungsgrenzen im Grundgesetz", Brief des Wissenschaftlichen Beirats beim Bundesministerium der Finanzen an den Bundesfinanzminister P. Steinbrück, 10th February 2007

**Wissenschaftlicher Beirat beim Bundesministerium für Wirtschaft und Technologie (2008)**, "Zur Begrenzung der Staatsverschuldung nach Art. 115 GG und zur Aufgabe des Stabilitäts- und Wachstumsgesetzes", Gutachten Nr. 01/08

---

1 The federal budget assumed the liabilities of the former GDR government and the restructuring costs of the outdated East German corporate sector. In addition, the 1990-94 operation of the *Treuhand* agency to privatise the East German enterprises was closed with a debt of ca. €130 bn.

2 For a detailed analysis of the revenue elasticity in Germany see *European Commission* (2008).

3 While the revenues were overestimated in the downturn after the dot.com bubble had burst in 2000, they were underestimated in the upturn 2006/2007, when the boost in revenues went considerably beyond normal cyclical sensitivity.

4 All tax legislation and expenditure legislation that significantly impacts the Länder budgets has to be passed jointly by the *Bund* (*Bundestag)* and the *Länder* (*Bundesrat*).

5 For more information on national budgetary coordination in Germany see European Commission (2007)

6 However, the federal government also controls social security through legislation.

7 From 2006, an amended Article 109 of German Constitution provides that in the case of EU sanctions the *Bund* and the *Länder* share the costs according to a ratio of 65:35. The *Länder* are required to contribute to the 35% designated as their responsibility on the basis of their population.

8 See *European Commission* (2003, 2006 and 2007).

9 For a detailed discussion of the weaknesses of the existing German budget rule see Baumann and Kastrop (2008).

10 BVerfGE 79, 311.

11 Financial Planning Council, Business Cycle Council (*Konjunkturrat*), Council of Economic Experts (*Sachverständigenrat*) and *Deutsche Bundesbank*.

12 In 2007 gross investment in Germany amounted to 1.5% of GDP (national accounts) and depreciation was in turn 1.6% of GDP. Thus, the net investment was actually negative. Furthermore, public investment subsidies to all sectors amounted to 0.8% of GDP.

13 See The Council of the European Union (2000 a, b).

14 BVerfGE 2 BvF 1/04, 133.

15 See Fischer, J., Jonung, L. and M. Larch (2006).

16 While in 2005 the EFC (provisionally) defined a range of 0-0.5% of structural deficit as the MTO, the Council in 2006 referred to a balanced budget (presented in the German stability program of Feb. 2006) as the appropriate MTO for Germany. For Member States that have adopted the euro and for ERMII countries the country-specific MTOs shall be specified within a range between -1% of GDP and 'in balance or surplus', in cyclically adjusted terms, net of one-off and temporary measures. The country-specific MTO can be revised when a major structural reform (e.g. pension reform) is implemented and in any case every four years.

17 In 2009 it is planned to revise the MTO of EU Member States in the light of new projections of the "implicit liabilities" due to the costs of population ageing.

18 Council Regulation (EC) No. 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies amended by Council Regulation (EC) No 1055/2005 of 27 June 2005

19 The BMF proposal specifies the parameters of the adjustment account for the federal government: the federal structural balance is set at 0.35% of GDP and the account is subject to a ceiling of 1-2% of GDP.

20 Set for the Euro zone and the ERM II countries.

21 See Janeba (2008).

22 For a detailed discussion see Groneck and Plachta (2008a).

23 Simulations suggest that both rules would allow public debt to be limited effectively. See Groneck and Plachta (2008b).

The *ECFIN Country Focus* provides concise analysis of a policy-relevant economic question for one or more of the EU Member States.
**Chief Editor:** Elena Flores, Jürgen Kröger, Directors - Economic and Financial Affairs
**Coordinating Committee:** Heinz Jansen, Mary McCarthy, Stefaan Pauwels, Ann Westman
**Layout:** Yves Bouquiaux, Fabrizio Melcarne
**E-mail:** ECFIN-CountryFocus@ec.europa.eu
**Website:** http://ec.europa.eu/economy_finance/publications/countryfocus_en.htm