Stabilitätsrat
Unabhängiger Beirat

THE FISCAL FRAMEWORK IN GERMANY – AUTONOMY AND JOINT RESPONSIBILITY

Eckhard Janeba

Chairman, Independent Advisory Board to the German Stability Council

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Germany: A federal country

Four layers of government	Expenditures shares
Federal government	(≈10% of GDP)
16 State governments (*Länder*)	(≈11% of GDP
About 11,000 local governments	(≈7% of GDP)
Social insurance	(≈19% of GDP)

- Note: Only core budgets, substantial fiscal equalization and vertical transfers between government layers

Autonomy and Joint Responsibility

- Art. 109 Basic Law establishes that the federal government and the state governments (Länder) are
  - autonomous of another in budgetary matters
  - jointly responsible for the obligations from European Union treaty/SGP

- How can that work?

Three Elements

1. Allocation of EU financial sanctions relating to Art. 126 TFEU
   - Federal government/Länder share burden 65/35%
   - Distribution within Länder 65% by causation, 35% by population shares

2. National fiscal rule: Debt Brake
   - Federal government: structural deficit of no more than 0.35% of GDP (from 2016 onwards)
   - Länder: Structurally balanced budget (from 2020 onwards)

3. Fiscal surveillance by Stability Council
   - Preventing budgetary emergencies through monitoring

Debt Brake („Schuldenbremse“)

- Issue 1: Which method is used for business cycle adjustment?
  - Federal government: EU method
  - Länder: their choice!

  ⇒Possible tension between European and national fiscal rules

- Issue 2: Aggregating deficits across government layers
  - Fiscal Compact Deficit target (0.5%) vs. debt brake (0.35% + 0)
  - Local governments autonomous but fiscal surveillance and fiscal transfers by Länder
  - Deficits in Social Insurance can be covered by decline in reserves, which deteriorates budgetary position from national accounts perspective

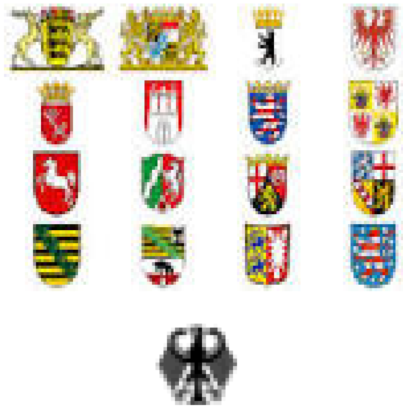
Germany‘s Budgetary Position (% of GDP)

	2015	2016	2017	2018	2019	2020
Surplus	0.7	½	¼	¼	½	½
Federal govt.	0.3	0	0	0	¼	¼
Länder	0.2	¼	¼	¼	0	¼
Local govt.	0.1	0	0	0	0	0
Social Insurance	0.1	¼	0	0	0	0

Note: Structural deficit in some years worse due to negative output gap.

Source: Documents, Stability Council meeting December 12, 2016

Fiscal Monitoring



- Stability Council
  - 16 Länder finance ministers
  - federal finance and economy ministers

- Monitoring of <u>federal and Länder budgets</u> over medium term using indicator-based system
  - Structural fiscal balance per capita
  - Credit financing ratio
  - Debt per capita
  - Interest-to-tax ratio

- Stability Council declares <u>state of budgetary emergency</u>
  - agreement and monitoring of budgetary rehabilitation program

Structural deficit indicator (€ p.c.)

Struktureller Finanzierungssaldo in € je Einwohner

	Bund *	BW	BY	BB	HE	MV	NI	NW	RP	SL	SN	ST	SH	TH	BE	HB	HH
2014	127	90	93	228	-75	61	-11	-88	-28	-593	385	52	13	78	214	-767	240
2015	164	76	93	226	41	138	-54	-15	30	-444	189	196	35	156	143	-835	117
2016	-82	-164	-138	-57	-117	-39	-83	-117	-68	-426	104	-66	-84	7	41	-1.179	-99
2017	-51	67	-24	-33	-45	-4	-98	-86	-49	-384	87	-21	-29	-64	30	-1.038	1
2018	30	65	21	2	40	39	-51	-14	-19	-283	96	47	39	26	11	-612	109
2019	44	102	25	14	67	40	-12	31	15	-168	167	70	55	29	-2	-355	179
2020	10		50	10	74	42	1	88	94	74	147		63	31	-7	-158	241

- Source: Stability Council, 14th meeting, Dec. 12, 2016

Discussion

- Issue 1: Weak enforcement power of Stability Council
  - Lack of sanction mechanism (withdrawal of temporary consolidation assistance?)
- Issue 2: No monitoring of Debt Brake (yet)
  - new legislation currently in parliamentary process
  - details on monitoring system and enforcement capacity unclear
- Issue 3: Who is independent fiscal institution?
  - Stability Council is a fiscal council, but not independent; Advisory Board is independent, but by itself not a fiscal council
  - Advisory Board consults only with respect to Fiscal compact, not monitoring of budgetary emergency or debt brake

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Conclusion

- In a federation there is a tension between budgetary autonomy for all government layers and joint responsibility for aggregate fiscal outcomes

- Solution needs clear rules, coordination and monitoring institution (in Germany: Stability Council + Advisory Board)

- Actual system is the outcome of a delicate power balance between federal government and Länder

- Some institutional frictions remain; Germany's fiscal framework not tested in crisis yet