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**
  - Federal government
  - 16 State governments (*Länder*)
  - About 11,000 local governments
  - Social insurance

- **Expenditures shares**
  - Federal government: \( \approx 10\% \) of GDP
  - 16 State governments: \( \approx 11\% \) of GDP
  - Local governments: \( \approx 7\% \) of GDP
  - Social insurance: \( \approx 19\% \) 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)

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Surplus</td>
<td>0.7</td>
<td>½</td>
<td>¼</td>
<td>¼</td>
<td>½</td>
<td>½</td>
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<tr>
<td>Federal govt.</td>
<td>0.3</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>¼</td>
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<tr>
<td>Länder</td>
<td>0.2</td>
<td>¼</td>
<td>¼</td>
<td>¼</td>
<td>0</td>
<td>¼</td>
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<tr>
<td>Local govt.</td>
<td>0.1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Social Insurance</td>
<td>0.1</td>
<td>¼</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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</tbody>
</table>

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 federal and Länder budgets 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 state of budgetary emergency
  - agreement and monitoring of budgetary rehabilitation program
### Structural deficit indicator (€ p.c.)

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<tr>
<th>Year</th>
<th>Bund</th>
<th>BW</th>
<th>BY</th>
<th>BB</th>
<th>HE</th>
<th>MV</th>
<th>NI</th>
<th>NW</th>
<th>RP</th>
<th>SL</th>
<th>SN</th>
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<td>2014</td>
<td>127</td>
<td>90</td>
<td>93</td>
<td>228</td>
<td>-75</td>
<td>61</td>
<td>-11</td>
<td>-88</td>
<td>-28</td>
<td>-593</td>
<td>385</td>
<td>52</td>
<td>13</td>
<td>78</td>
<td>214</td>
<td>-767</td>
<td>240</td>
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<tr>
<td>2015</td>
<td>104</td>
<td>76</td>
<td>93</td>
<td>226</td>
<td>41</td>
<td>138</td>
<td>-54</td>
<td>-15</td>
<td>30</td>
<td>-444</td>
<td>189</td>
<td>198</td>
<td>35</td>
<td>156</td>
<td>143</td>
<td>-835</td>
<td>117</td>
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<tr>
<td>2017</td>
<td>-51</td>
<td>67</td>
<td>-24</td>
<td>-33</td>
<td>-45</td>
<td>-98</td>
<td>-88</td>
<td>-49</td>
<td>-394</td>
<td>87</td>
<td>-21</td>
<td>-29</td>
<td>-54</td>
<td>30</td>
<td>-1.038</td>
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<tr>
<td>2018</td>
<td>30</td>
<td>65</td>
<td>21</td>
<td>2</td>
<td>40</td>
<td>39</td>
<td>-51</td>
<td>-14</td>
<td>-283</td>
<td>98</td>
<td>47</td>
<td>39</td>
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<td>2019</td>
<td>44</td>
<td>102</td>
<td>25</td>
<td>14</td>
<td>87</td>
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<td>31</td>
<td>-168</td>
<td>167</td>
<td>70</td>
<td>55</td>
<td>29</td>
<td>-2</td>
<td>-355</td>
<td>179</td>
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<tr>
<td>2020</td>
<td>10</td>
<td>50</td>
<td>10</td>
<td>74</td>
<td>42</td>
<td>1</td>
<td>88</td>
<td>94</td>
<td>74</td>
<td>147</td>
<td>83</td>
<td>31</td>
<td>-7</td>
<td>-158</td>
<td>241</td>
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- 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
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