Stabilitätsrat
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THE FISCAL FRAMEWORK IN GERMANY – AUTONOMY AND JOINT RESPONSIBILITY

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Germany: A federal country

Four layers of government	Expenditure share, core budget
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)

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

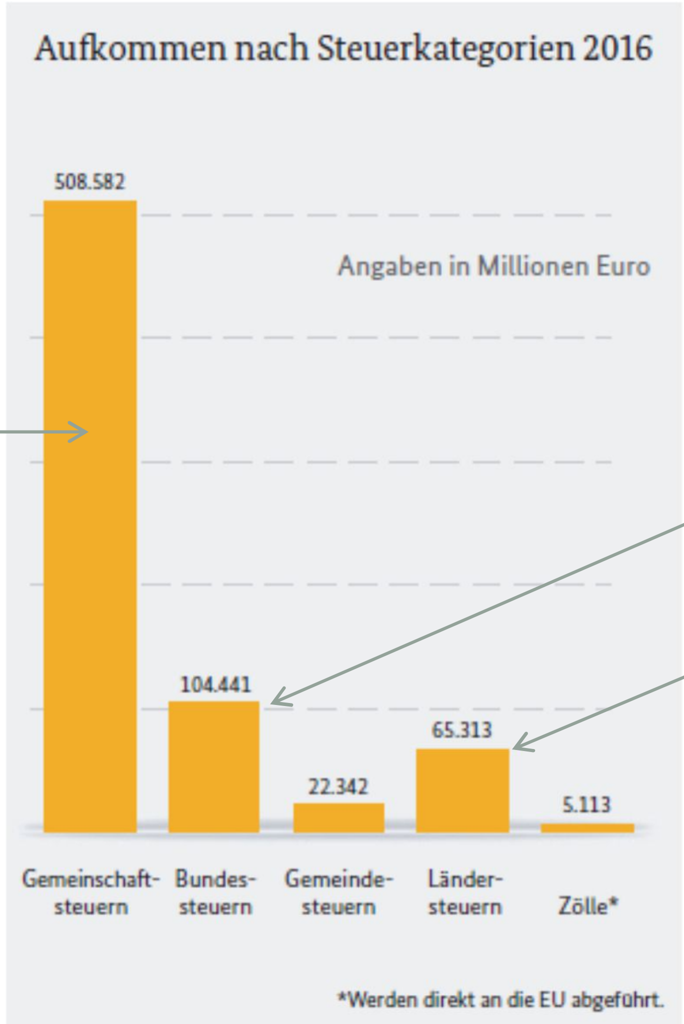
Source: Documents, Stability Council meeting December 12, 2016

Fiscal Federalism in Germany

- Joint taxation power of federal and state governments (≈ 70% of all tax revenues)
- States are quite diverse in terms of GDP, budget deficit and debt
- Extensive horizontal and vertical fiscal equalization scheme (volume approx. 0.75% of GDP)
- Despite huge debt differences among states, solid bond rating for all states => Implicit bailout guarantee by constitution

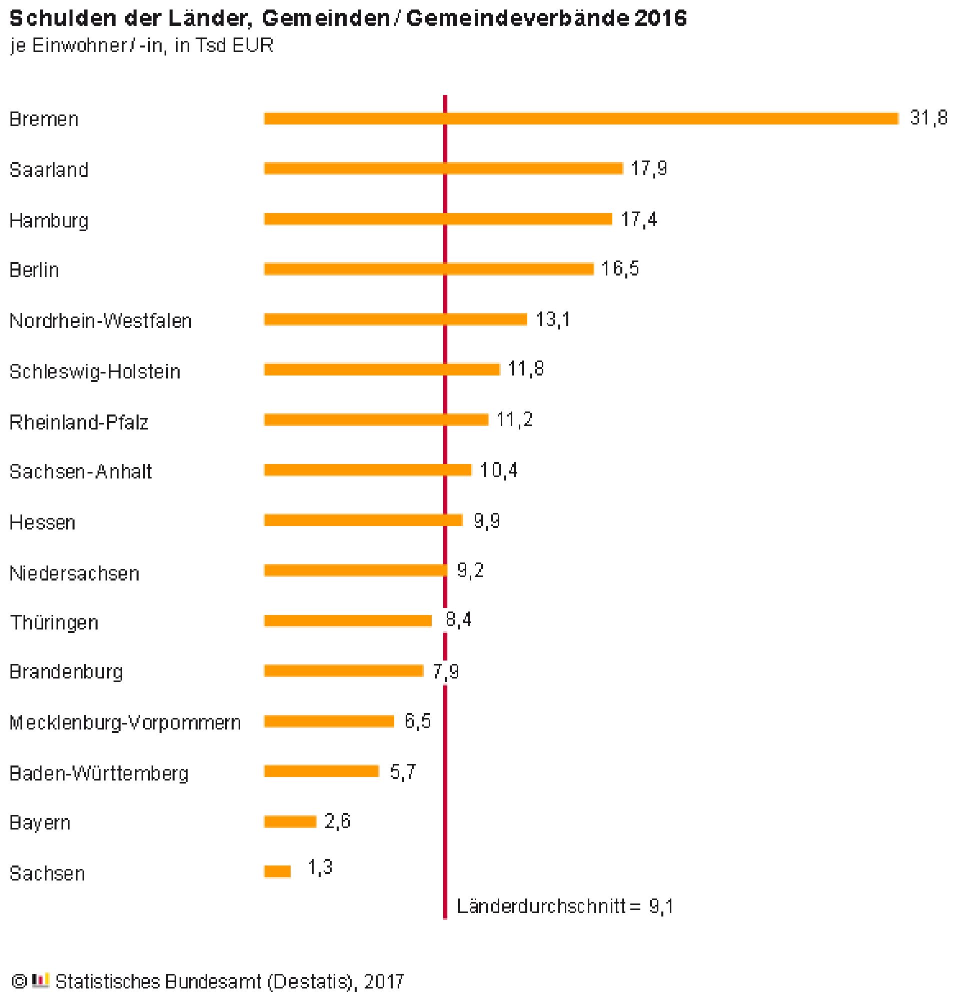
Joint and exclusive tax bases

Joint: VAT, Corporate & Income Tax



Exclusive federal and states

Debt in € per capita, states 2016



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

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

Discussion

- Issue 1: Weak enforcement power of Stability Council
  - Lack of sanction mechanism

- Issue 2: No/unclear monitoring of Debt Brake
  - Initial no monitoring of debt brake
  - new legislation recently passed, details unclear

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Conclusion

- Germany is a mixed country in terms of fiscal decentralization
- Tension between budgetary autonomy for all government layers and joint responsibility for aggregate fiscal outcomes
- This makes clear rules, coordination and strong monitoring institution necessary
- 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