

Dr. William Brunton

Dr, Martin Snelting

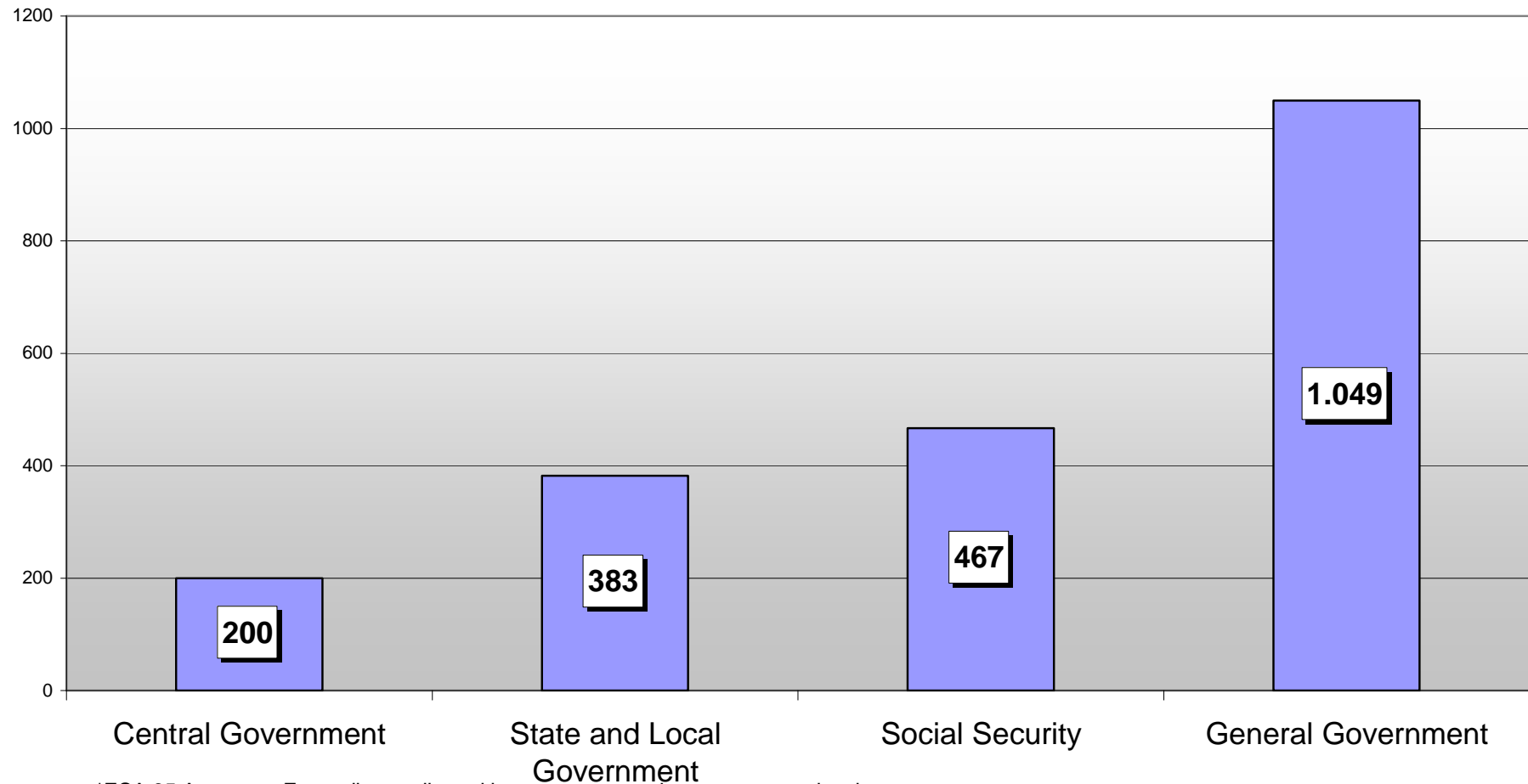
The National Stability Pact in Germany

24 March 2006

Questions of the lecture:

- 1. How have domestic institutions been affected by the SGP?**
- 2. What is the view of the states in the discussion of implementing the (new) SGP by domestic rules?**
- 3. Is there any horizontal (between Germany and other MS) or vertical (between Germany and the EU) interaction in the sense of laboratory “European” federalism?**

**DE: Immediate Government
Expenditure * 2005
- Bn € -**

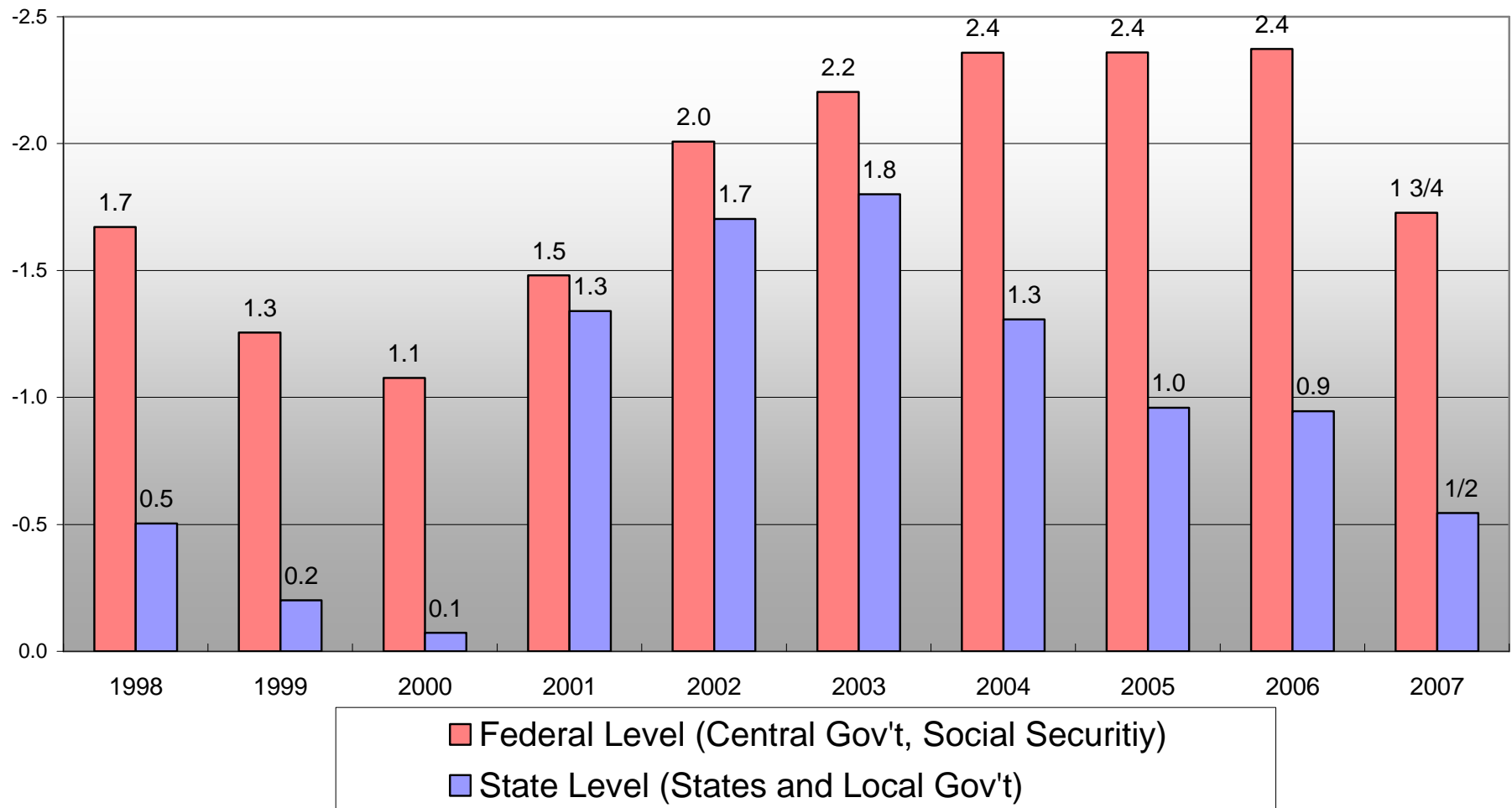


*ESA 95 Accounts, Expenditure adjusted by payments to other government levels

Key elements of the German fiscal constitution:

- **2/3 of tax revenue (personal and corporate income tax, VAT) accrues from “common” taxes which are shared by federal and state governments**
- **The vertical distribution of VAT is designed to ensure equal coverage of federal and state expenditures (vertical fiscal equalisation)**
- **Redistribution of tax revenues leads to a roughly equal per capita fiscal capacity of the states (horizontal fiscal equalisation)**
- **The federal government and the state governments can independently borrow freely within the limitations of the federal and all state constitutions (i.e. borrowing should be less than capital expenditures incl. financial transactions). States with serious budget imbalances can receive special financial assistance**

Net Borrowing: Federal Level in comparison with State Level - in % of GDP -



The national stability pact in Germany – Step I

§ 51a Budget Principles Law, negotiated by the financial planning council on 21 March 2002:

- **Federal government and the states aim to reduce net borrowing until their budgets are balanced**
- **The recommendations of the financial planning council for a common expenditure line are designed to ensure that the guidelines of the SGP for limiting the general government deficit are met**
- **The financial planning council issues recommendations to restore budget discipline in case fiscal goals are not met**

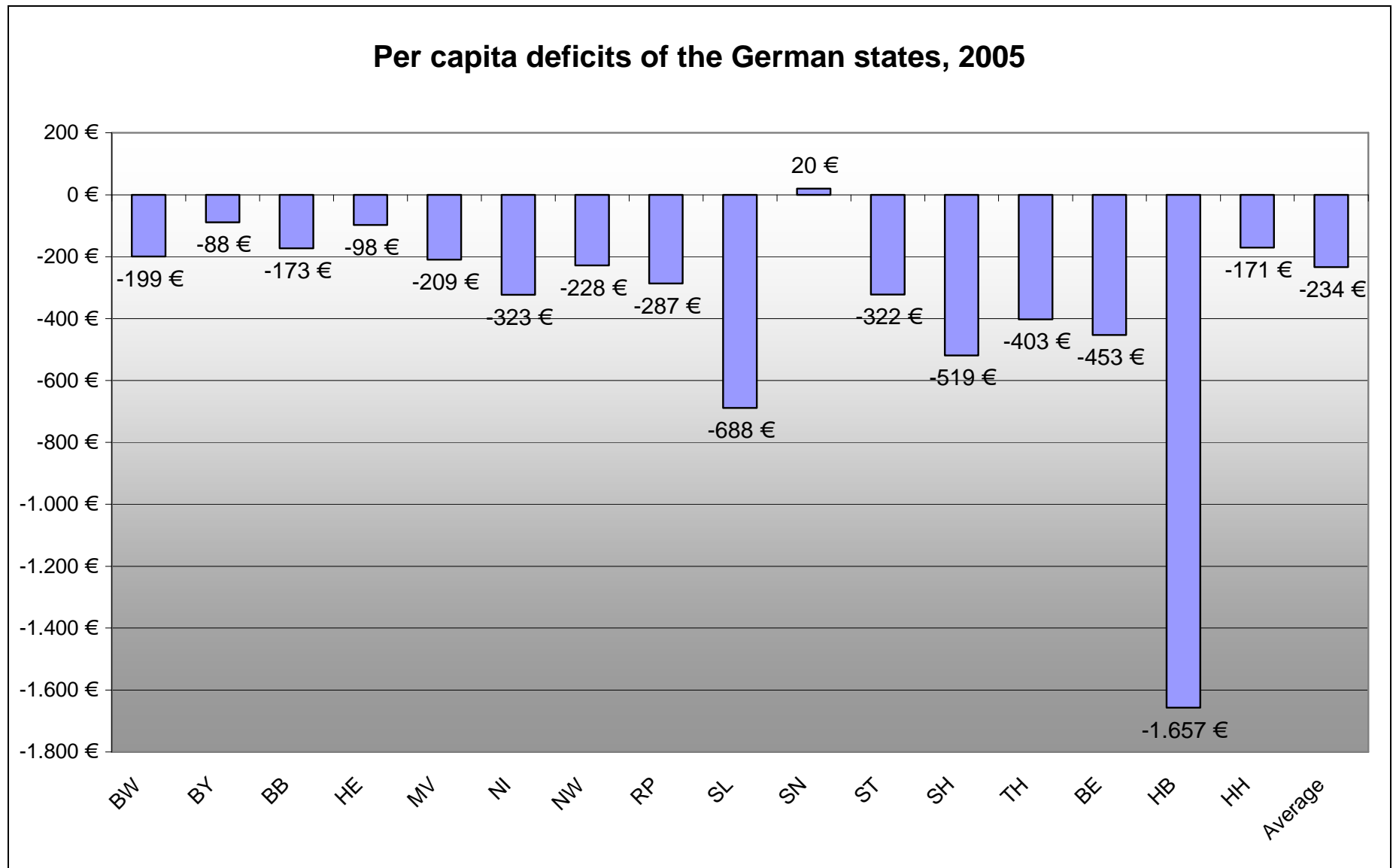
The national stability pact in Germany – Step II

Proposal of the law to change the constitution and reform federalism, adopted by the Federal Government and the Bundesrat in March 2006:

- **Sanctions imposed by the EU according to Article 104 (11) of the European Treaty are shared by the federal government and the states at the ratio of 65 : 35.**
- **35% of the states' share is distributed among the states according to population, 65% according to the ratio of the individual budget deficit to the overall deficit of the states.**

The national stability pact in Germany – the view of the states

- **The states are clearly committed to the objectives of the European SGP and to the common responsibility of the federal and states levels to ensuring national compliance**
- **The stability pact is a significant innovation of the German fiscal constitution, as it provides an incentive for deficit reduction at the level of the individual state**
- **The sanction mechanism agreed to in the national stability pact will introduce significant incentives for state budget discipline**



**Effect of national fiscal institutions on the objectives
of the national stability pact**

- **The general fiscal framework of German states is characterized by strong budget autonomy but no taxing authority**
- **The Financial Planning Council is the central instrument designed to coordinate budget policies of the federal, state and local levels**
- **State constitutional provisions support the objectives of the national stability pact at the state and local levels**

Effect of the reform of German federalism on the national stability pact

- **German federalism is a model of cooperative federalism. The current reform is designed to introduce more elements of competition into the federal system**
- **The reform currently in parliament will increase legislative authority and budget flexibility of the states**
- **A more far-reaching reform which would realize the structures preferred in the normative theory of fiscal federalism faces enormous economic, political and constitutional hurdles**

Conclusions for the “European laboratory federalism“

- **The reform of the national institutions in Germany was induced by the SGP**
- **Because of very specific national institutions, concepts of other member states could not be adopted**
- **For the same reason, other member states or the EU COM could barely benefit from the experiences in Germany**
- **Thus, in the case of fiscal institutions, the concept of laboratory federalism seems not to hold for the European level**
- **According to the evolutionary institutional approach, adopting experiences from other member states postulate quite similar sets of institutions at the starting point of a reform.**