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Germany

What is the "Golden Rule"?

In the summer of 2011, the French government introduced a bill to amend France's constitution to include a budgetary "golden rule". Within the context of French and German proposals to save the euro, the golden rule was invoked once again on 5 December 2011. Both Paris and Berlin recommended that it be harmonised at European level[1] to improve economic government in the euro area.

In France, the idea of the golden rule is strongly reminiscent of its German counterpart. But what exactly is Germany's golden rule, and what does it cover?

1949: The golden rule is made part of Germany's constitution

Article 110 of Germany's *Grundgesetz* (GG), or constitution, stipulates that "the budget shall be balanced with respect to revenues and expenditures." Article 115 states that "revenue obtained by borrowing shall not exceed the total of investment expenditures provided for in the budget" and that "exceptions shall be permissible only to avert a disturbance of the overall economic equilibrium."
This rule did not prevent Germany's debt from accumulating. Over the years, like many other EU Member States, Germany amassed debt over the years at both Federal and *Länder* levels in order to balance their respective budgets. As a result, interest payments are constantly on the rise and contribute to deepening the country's deficit.

1989: The price of reunification

The reunification of the Federal Republic of Germany (FRG) and the German Democratic Republic (GDR) had a lasting impact on public finances. The *Bund* absorbed the GDR's public debt, and then redistributed it equitably between the new post-reunification *Länder* and the Federal state. Subsequently, Germany invested heavily in order to modernise the former East's sagging industry and spotty public services, pushing German public debt from the equivalent of €623 billion in 1991 up to €1.04 trillion in 1995[2] (an increase of 67%).

2009: The economic crisis

In 2008, the OECD pointed out that the golden rule methodology enshrined in the German constitution "has not proved to be effective," observing that "it has prevented neither a rise in the debt level nor pro-cyclical policies[3]" and that its systematic use outstripped any need to "avert a disturbance of the overall economic equilibrium."

Thus, establishing a budget without incurring further debt is become increasingly difficult, and Germany runs the risk that its public debt will exceed the Maastrict-imposed limit of 3% of GDP.

[1] http://in.reuters.com/article/2011/12/05/eurozone-agreement-idINDEE7B40IL20111205
[2] http://www.haushaltssteuerung.de/verschuldung-gesamt-deutschland.html
[3] Economic Survey of Germany 2008, OECD, http://www.oecd.org/document/8/0,3746,en_2649_34111_40352840_1_1_1_1,00.html

The new "debt brake" in both Federal and *Länder* budgets

To prevent public debt from rising, in 2009 the German Federalism Commission (*Föderalismuskommission*[4]) proposed the creation of a *Schuldenbremse*, or debt brake. This mechanism was adopted by the Bundestag on 29 May 2009[5], and confirmed by a two-thirds majority vote in the Bundesrat on 12 June 2009, despite opposition votes from the Berlin, Mecklenburg-Pomerania and Schleswig-Holstein *Länder*. As a result, the Constitution was amended on 1 August 2009.

The new provisions are defined in Articles 109 and 115, and were applied starting in budgetary year 2011[6]. They have to do primarily with the balanced budget principle, meaning that "revenues and expenditures shall in principle be balanced without revenue from credits." Exceptionally, structural indebtedness at the federal level is authorised, provided it is not exceed 0.35% of GDP. This applies solely to the *Bund*; the objective for the Länder remains 0%. Nevertheless, under a transitional provision, deviations from the norm will be tolerated until the end of 2015 for the *Bund*, and until the end of 2019 for *Länder*[7].

However, even after this transition period, there may be exceptions to the golden rule: "in cases of natural catastrophes or unusual emergency situations beyond governmental control and substantially harmful to the state's financial capacity, these credit limits may be exceeded[8]." In these strictly defined cases, Germany has thus left itself the possibility of having recourse to credit.

Questioning the debt brake

Enshrining the debt brake in Germany's Constitution has raised doubts as to whether this is in compliance with the Constable of federalism. The issue is whether banning structural debt for the *Länder* – part of the new provisions – compromises the principle of budgetary autonomy of the *Länder* vis-à-vis the Bund.

Defenders of the amendment respond that budgetary autonomy for the *Länder* is restricted in any sense, since the Federal financial system is a complex structure that must comply with rules governing fiscal equalisation and allocation of taxes. It is true that the debt brake regulates public borrowing, but this framework nevertheless leaves the *Länder* free to adopt their own budget. Since the Bundesrat – the *Länder*'s representative assembly – confirmed the introduction of the debt brake into the Constitution by a two-thirds majority, this discussion is merely an academic one, and is not seriously pursued at a political level.

The sole appeal against the debt brake was filed by Schleswig-Holstein; it was rejected in September 2011 by the Federal Constitutional Court for formal reasons. In the meantime, Schleswig-Holstein has enshrined the debt brake in its own constitution.

The "golden rule" at European level

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, which was finalised on 30 January 2012[9], calls for the adoption of a "balanced budget rule" by the 25 Member State signatories [with the UK and the Czech Republic deciding to opt out]. The Treaty is expected to be formally signed in early March 2012. It must then be ratified by at least 12 Member States to enter into force. This European "golden rule" requires the signatories to enact balanced budgets by limiting their

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[4] The Joint Bundestag–Bundesrat Commission on Modernising Federal-State Financial Relations (Federalism Commission II – 2007–2009) consisted of 32 members: 16 deputies from the Bundestag (6 from the CDU party, 6 from the SPD, 2 from the FDP, 1 from Alliance 90/The Greens and 1 from Die Linke) and 16 delegates from the Bundesrat (the Prime Ministers of the *Länder* and the mayors of Germany's independent cites). In addition, there were four representatives from the *Länder* parliaments who were allowed to speak and ask questions but did not have voting rights, and three representatives from the *Kommunale Spitzenverbände*, or municipal associations.

[5] Bundesgesetzblatt BGBl. 2009 I S. 2248

[6] GG: Article 143d (1), sentence 1

[7] GG: Article 143d (1), sentences 2 and 4

[8] GG: Article 115 (2), sentence 5

[9] http://www.european-council.europa.eu/home-page/highlights/the-fiscal-compact-ready-to-be-signed-%282%29?lang=en

deficit to 0.5% of GDP. Each Member State will also have to adopt the Treaty by amending its constitution or by passing a law.

Martin Chaudhuri
Deputy Head of the central personnel division of the Federal Ministry of Finance, currently seconded to the IGPDE within the framework of a Franco-German exchange