Germany’s Federal Debt Brake
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I. Background and basic structure

Background

Germany’s constitutional rule on federal indebtedness\(^1\) has been in practice since the 2011 fiscal year. Known as the “debt brake” – and part of the 2009 reforms to Germany’s federal structure – this rule replaced the “golden rule” that was applicable until 2010 and that was contained in the old version of Article 115 of Germany’s constitution, the Basic Law (see section III, Legal bases).

Figure 1: Trends in public budget debt in % of GDP

\(^{1}\) Further information on national and European fiscal rules is available at: http://www.bundesfinanzministerium.de/Web/DE/Themen/Oeffentliche_Finanzen/Fiskalregeln/nationale_europaeische_fiskalregeln.html
Figure 1 shows the notable increase in public budget debt since the old version of Article 115 of the Basic Law entered into force in the late 1960s. This is illustrated on the basis of trends in the debt-to-GDP ratio. In 2009, the debt-to-GDP ratio (including off-budget entities) was 42.1% for the Federation and 21.4% for Germany’s federal states, the Länder. The level of borrowing stood at 8.2% of GDP and 3.9% of GDP respectively in 1970. This unfavourable trend especially at federal and Länder level led to an increase in public budget debt from approximately 20% in the 1950s, 1960s and early 1970s to 69.0% in 2009.

The debt-to-GDP ratio was 72.4% in 2009 if the Maastricht definition is applied, because the Maastricht definition uses a different methodology which includes, for example, liquidity loans, holding arrangements and other corrections arising from the support given to banks.

Institutional and economic conditions have changed considerably since the reform of the constitutional rule on public finances in 1969. As a member of European economic and monetary union, Germany must comply with the quantitative and qualitative requirements of the European Stability and Growth Pact. In addition, together with 24 other EU member states, Germany signed the “Treaty on Stability, Coordination and Governance in the Economic and Monetary Union” (fiscal compact) in 2012. Consistent implementation of these obligations at national level is a crucial condition for the stability of the euro and the future viability of the common economic area.

Experiences from the economic and financial crisis also prove how important it is to have a state that is capable of fiscal policy action at all times. The comprehensive stimulus measures taken during the financial and economic crisis were justifiable only because they were an exception. A very conscious decision was therefore taken at the same time to enact reforms to the constitutional budget rule. In this way, the debt brake makes a key contribution to the credibility of German fiscal policy.

Furthermore, demographic change and the associated spending on social security mean that there is a high level of additional implicit national debt. To ensure that public finances are sustainable in the long term, the debt-to-GDP ratio must be reduced on a long-term basis. This will reduce the relative burden of interest payments on public budgets. Durably sound public budgets are an essential precondition for sustainable growth and the sustained strong performance of the economy. The pursuit of responsible budget policy thus makes a decisive contribution to maintaining prosperity and social security.

Basic structure of the debt brake

The principle of having (structurally) balanced budgets at federal and Länder level is enshrined in Article 109 of the Basic Law. The introduction of this principle replaced the “golden rule” policy set out in the old version of Article 115 of the Basic Law. The reform of the budget rule therefore adheres to the philosophy of the European Stability and Growth Pact, according to which EU Member States’ budgets should be “close to balance or in surplus” (medium-term budgetary objective).

The basic structure of the debt brake and the method for calculating maximum permissible net borrowing are shown in Figure 2 and explained in greater detail below.
Limited scope for structural net borrowing

To safeguard the **sustainable development of public finances** over the long term, net borrowing must be kept at a level that ensures the debt-to-GDP ratio is reduced on a sustained and long-term basis. In order to ensure that this goal is achieved, European rules limit the structural deficit to the medium-term budgetary objective, which is specified individually for each member state. Accordingly, the maximum structural deficit for Germany (this encompasses the Federation, Länder, local authorities and social security funds, including their off-budget entities) is 0.5% of GDP.

In line with the principle of maintaining balanced budgets, Article 115 of the Basic Law gives the Federation narrowly confined scope for **structural** borrowing – **irrespective of the economic situation**. This **structural component** constitutes an integral part of the maximum permissible amount of net borrowing. From 2016 onwards, this structural component is capped at 0.35% of GDP. Moreover, it will **no longer be possible** to circumvent the upper limit (stipulated in Article 115 of the Basic Law) through the creation of special funds, because all special funds established since 2011 are subject to the debt brake rule.
This type of scope for structural net borrowing is certainly justifiable within a limited framework – namely when it is used for measures that aim to **enhance long-term growth and sustainable development** and thus to benefit future generations in particular. Creating scope for structural net borrowing does not necessarily mean that it is to be exploited every time the budget is prepared. This applies all the more given that, in terms of operating the debt brake, it is useful to maintain a safety margin in relation to the upper limit for net borrowing when preparing the budget.

**Adjustment for financial transactions**

To achieve the closest possible alignment between the fiscal balance required under the debt brake on the one hand, and the one required under European rules on the other, revenue and expenditure are adjusted for **financial transactions** when calculating the upper limit for net borrowing (see section III: Legal bases – section 3 of the Article 115 Act). This is a change to previous practice and ensures, for example, that privatisation proceeds can no longer be used as a means to comply with borrowing limits. This also facilitates more sustainable budget policies.

**Symmetrical treatment of economic cycles**

In addition to securing the long-term sustainability of public finances, the debt brake also enables the pursuit of **fiscal policy that is responsive to cyclical conditions**. This is done by taking account of cyclical influences on public budgets. The method involves a **cyclical component** (section 5 of the Article 115 Act) which raises the upper limit for net borrowing in downturns and lowers it when the economy is performing well. Under the debt brake, the only fiscal policy option generally available for stabilising the economy is to allow automatic stabilisers to operate in both directions.

By stipulating the symmetrical treatment of cyclical effects, the legislature **eliminated** a major design flaw from the old version of Article 115 of the Basic Law, which had provided for government action to stabilise the economy only during phases of recession and had not required a **corresponding reduction in net borrowing during upturns**. The technical procedure for determining the cyclical component is defined in an ordinance (see section III: Legal bases – Article 115 Ordinance). It follows the cyclical adjustment method applied in European budget surveillance processes.
Binding dimension when preparing and executing the budget

To ensure that public finances are sustainable, it is not enough for budget rules simply to restrict net borrowing when the budget is drawn up – which was the case under the old version of Article 115 of the Basic Law. Therefore, to ensure that the Federation’s debt brake provisions are also complied with when the budget is executed, a federal control account was set up which is required to be balanced.

The control account (cf. section 7 of the Article 115 Act) records non-cyclical deviations from the standard upper limit that arise in individual fiscal years during execution of the budget. Such deviations can occur even if the budget is prepared in compliance with the rules – for example, in cases where the financial impact of a tax reform is forecast incorrectly. Deviations from projected economic outcomes, however, are subsequently factored into the cyclical component in the form of updated automatic stabilisers and therefore do not appear on the control account.

The control account is debited if actual net borrowing exceeds the maximum permissible net borrowing as calculated at the end of the relevant fiscal year on the basis of the actual cyclical effect on the budget. If actual net borrowing is kept below the upper limit, the control account is credited in the amount of the difference between actual net borrowing and the maximum permissible amount. Annual debits and credits on the control account are netted.

If a cumulative negative balance on the control account exceeds a threshold of 1.5% of GDP, the provisions of the Basic Law require this excess to be reduced in a manner appropriate to the cyclical situation. The implementing provisions, which are set out in ordinary legislation as opposed to constitutional law, state that the obligation to reduce net borrowing applies only during an economic upturn. Furthermore, the amount of the reduction to be made is limited to 0.35% of GDP annually. Because this spreads repayment over time, the obligation, set out in ordinary legislation, to reduce net borrowing already applies at a lower threshold value of 1% of GDP.

The cumulative balance of the control account for the period encompassing the fiscal years from 2011 to 2015 will be cancelled (cf. section 9 subsection (3) of the Article 115 Act) at the end of the transition period under Article 143d of the Basic Law.
Control account: Sample accounting of debt brake parameters for the federal budget in 2012

For fiscal year 2012, the amount by which actual net borrowing deviated from the updated standard upper limit was provisionally posted to the control account on 1 March 2013 in accordance with section 7 of the Article 115 Act and then conclusively posted on 1 September 2013. Actual net borrowing encompasses the net borrowing of the Federation together with the fiscal balances (with the signs – i.e. plus or minus – reversed) of any special funds newly established by the Federation since the debt brake entered into force. This means that, for 2012, the actual net borrowing figure also took into account the fiscal balance of the Energy and Climate Fund established in 2011. Under the debt brake rule, the maximum permissible amount of net borrowing in 2012 following closure of the budget was €53.2 billion (shown under position 8 in the “Actual” column of Figure 3). This amount is the sum of the following three figures: the amount of maximum permissible structural net borrowing as stipulated under the binding deficit reduction path (€39.4 billion); executed financial transactions (a balance of –€7.4 billion, shown under position 5 in the “Actual” column of Figure 3); and the cyclical component as adjusted for actual economic outcomes (–€6.4 billion, shown under position 6 of the “Actual” column of Figure 3).

The cyclical component is updated/adjusted as follows: The difference is calculated between (a) the nominal GDP growth rate for 2012 that was projected at the time the budget was prepared (in fall 2011) and (b) the nominal GDP growth rate for 2012 as calculated by the Federal Statistical Office in August 2013; this amount is then added to the output gap calculated at the time the budget was prepared. Because the actual rate of nominal GDP growth in 2012 was slightly lower than the rate projected when the budget was prepared in fall 2011, the actual cyclical component for fiscal year 2012 was adjusted slightly downward – i.e. increased in absolute terms – vis-à-vis the projected cyclical component.

In 2012, the Federation’s structural net borrowing (i.e. net borrowing adjusted for financial transactions and cyclical effects) stood at €8.5 billion, or 0.34% of GDP (shown under position 9 in the “Actual” column of Figure 3). This meant that the Federation’s structural net borrowing already succeeded in complying with the permanent upper limit of 0.35% of GDP in just the second year since the debt brake took effect – and four years earlier than required by the constitution.

A positive entry of €30.9 billion was posted to the control account for fiscal year 2012 (shown under position 10 in the “Actual” column of Figure 3). When added to the previous year’s balance of €25.2 billion, this resulted in a cumulative positive balance of €56.1 billion on the control account in 2012.
Figure 3: Debt brake parameters for the federal budget in 2012 (projected and actual)

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
<th>2012</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Maximum permissible structural net borrowing (in % of GDP)</td>
<td>Projected* 1.59</td>
<td>Actual</td>
</tr>
<tr>
<td>2</td>
<td>Nominal GDP for year preceding preparation of the budget (at time of budget preparation)</td>
<td>2 476.8</td>
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<tr>
<td>3</td>
<td>Maximum permissible structural net borrowing (1) x (2)</td>
<td>39.4</td>
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<tr>
<td>4</td>
<td>Net borrowing</td>
<td>26.1</td>
<td>22.3</td>
</tr>
<tr>
<td></td>
<td>4a Net borrowing (federal budget)</td>
<td>26.1</td>
<td>22.5</td>
</tr>
<tr>
<td></td>
<td>4b Balance of Energy and Climate Fund</td>
<td>-</td>
<td>0.2</td>
</tr>
<tr>
<td>5</td>
<td>Balance of financial transactions</td>
<td>4.3</td>
<td>- 7.4</td>
</tr>
<tr>
<td></td>
<td>5a Revenue from financial transactions</td>
<td>6.9</td>
<td>4.8</td>
</tr>
<tr>
<td></td>
<td>5aa Revenue from financial transactions (federal budget)</td>
<td>6.9</td>
<td>4.8</td>
</tr>
<tr>
<td></td>
<td>5ab Revenue from financial transactions (Energy and Climate Fund)</td>
<td>-</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>5b Expenditures from financial transactions</td>
<td>2.7</td>
<td>12.2</td>
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<tr>
<td></td>
<td>5ba Expenditures from financial transactions (federal budget)</td>
<td>2.7</td>
<td>12.2</td>
</tr>
<tr>
<td></td>
<td>5bb Expenditures from financial transactions (Energy and Climate Fund)</td>
<td>-</td>
<td>0</td>
</tr>
<tr>
<td>6</td>
<td>Cyclical component</td>
<td>- 5.3</td>
<td>- 6.4</td>
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<tr>
<td></td>
<td>Projected: (6a) x (6c)</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>Actual: [(6a) + (6b)] x (6c)</td>
<td>- 33.3</td>
<td>- 6.5</td>
</tr>
<tr>
<td></td>
<td>6a Nominal output gap (at time of budget preparation)</td>
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<td></td>
</tr>
<tr>
<td></td>
<td>6b Adjustment for actual economic outcomes</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>[Actual (6ba) – Projected (6ba)]% x (6bb)</td>
<td>- 6.5</td>
<td></td>
</tr>
<tr>
<td></td>
<td>6ba nominal GDP (year-on-year change in %)</td>
<td>2.4</td>
<td>2.2</td>
</tr>
<tr>
<td></td>
<td>6bb nominal GDP of previous year</td>
<td>2 609.9</td>
<td></td>
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<tr>
<td></td>
<td>6c Budget semi-elasticity (without unit)</td>
<td>0.160</td>
<td></td>
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<tr>
<td>7</td>
<td>Required reduction from control account</td>
<td>-</td>
<td></td>
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<tr>
<td>8</td>
<td>Maximum permissible net borrowing</td>
<td>40.5</td>
<td>53.2</td>
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<tr>
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<td>(3) - (5) - (6) - (7)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Structural net borrowing</td>
<td>25</td>
<td>8.5</td>
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<tr>
<td></td>
<td>(4) + (5) + (6) in % of GDP</td>
<td>1.01</td>
<td>0.34</td>
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<td>10</td>
<td>Debit/credit to control account</td>
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<td>30.9</td>
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<td></td>
<td>(8) - (4) oder (3) - (9)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Control account balance (previous year)</td>
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</tr>
<tr>
<td>12</td>
<td>Control account balance (new)</td>
<td></td>
<td>56.1</td>
</tr>
</tbody>
</table>

Discrepancies in sums and products may occur due to rounding.

* 2012 projections are drawn from the 2012 Budget Act of 22 December 2011 (Federal Law Gazette I, p. 2938)
Securing the state’s ability to act in emergency situations

The debt brake contains an exception (cf. Article 115 paragraph (2) of the Basic Law; section 6 of the Article 115 Act) that is designed to ensure that the government, and the parliamentary majority upon which it rests, can take action in special circumstances. At the same time, steps have been taken to prevent “abuse” of the exception. Compared with the old version of Article 115 of the Basic Law, which permitted increased net borrowing to avert a “disturbance of the overall economic equilibrium”, the exception under the debt brake is more narrowly formulated.

Under the debt brake, the constitutional net borrowing limit may be exceeded only in the event of natural disasters or unusual emergency situations which are outside the control of government and have a major impact on the financial position of the government. Normal cyclical downturns do not constitute grounds justifying application of the exception. Furthermore, the Bundestag may only take recourse to the exceptional arrangement if at least a majority of its members approve. Finally, in such cases the Bundestag must approve an amortisation plan that provides for net borrowing above the standard limit to be reduced within a reasonable time frame. The amount to be recorded on the control account must also be adjusted for the amount of net borrowing increased in this way.

Course for reducing the structural budget deficit

The debt brake and all its components apply fully from the 2011 fiscal year onwards. A transitional arrangement (see section III: Legal bases – Article 143d paragraph (1) of the Basic Law; section 9 of the Article 115 Act) permits an increased structural component only up to and including the year 2015. This means that the structural deficit from the 2010 federal budget must be reduced in regular annual increments by that time. In order to ensure that the accumulated positive entries posted to the control account during the transition period do not distort the function of the control account after the transition period is over, a provision was included in the Fiscal Compact Implementation Act of 15 July 2013 stipulating that the cumulative balance on the control account will be cancelled when the transition period ends on 31 December 2015.

Initial results since the debt brake’s entry into force

Sustained compliance by the Federation and Länder with the respective limits on structural new borrowing as prescribed by the debt brake is leading to a substantial and lasting reduction in the general government debt-to-GDP ratio.

After reaching a peak of 80.3% in 2010 (which also reflected the effects of the financial and economic crisis), Germany’s Maastricht debt ratio has declined markedly in the ensuing years. This development is the result of various factors. These include the Federation’s success since 2012 in complying with – and sometimes even coming in well under – the standard limit on structural new borrowing of 0.35% of GDP, as well as the progress made by many of the Länder in complying with their respective debt brakes (i.e. structurally balanced budgets) ahead of schedule. It is expected that the debt-to-GDP ratio will continue to decline in the coming years, especially since the Federation will be legally obliged to comply with 0.35%-of-GDP cap on structural new borrowing from 2016 onwards, and the Länder are required to implement their debt brakes by 2020.
Figure 4: Decline in Maastricht debt ratio

Maastricht debt ratio in % of GDP

2014: projection
As of November 2014
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II. Glossary

Automatic stabilisers

When the economy is performing poorly, tax revenue declines (compared with revenue under normal economic circumstances) and government spending increases – particularly due to rising transfer payments. As a result, public budgets exert an automatic stabilising effect on the economic process. A similar stabilising effect occurs when the economy is performing well. The cyclical component of the debt brake ensures that these automatic stabilisers can and must operate during good and bad economic times, thereby leading at all times to fiscal policies that are responsive to economic cycles.

Control account

In contrast to the provisions under the old version of Article 115 of the Basic Law, the debt brake is not limited only to the budget preparation process. Rather, under the debt brake, actual net borrowing is compared with the amount of maximum permissible net borrowing for a given fiscal year, and any differences are posted to a control account. If actual net borrowing is less than the upper limit, a positive entry is posted to the account; if actual net borrowing exceeds the upper limit, a negative entry is posted to the account. These entries are treated cumulatively across fiscal years. In this way, the control account constitutes a virtual “memory” that shows whether or not the debt brake is being complied with. If the balance of entries on the control account exceeds a specific negative threshold, immediate budget policy action is required, as the Basic Law stipulates that such situations must be remedied and the control account balance improved. In this way, the debt brake makes a decisive contribution to the long-term sustainability of public finances.

Once a given fiscal year’s budget is actually executed, a provisional entry is posted to the control account on 1 March of the following year on the basis of provisional figures on the aggregate performance of the economy. The conclusive entry is then posted on 1 September of that year. Figure 3 shows the control account entry that was made in 2012.

In order to ensure that the accumulated positive entries posted to the control account during the transition period up to 2015 do not distort the function of the control account after the transition period is over, a provision was included in the Fiscal Compact Implementation Act of 15 July 2013 stipulating that control account balance accumulated up to that point will be cancelled when the transition period ends on 31 December 2015.
Cyclical component

The cyclical component (cf. section 5 of the Article 115 Act; Article 115 Ordinance) factors in cyclically induced changes in revenue and spending. It is necessary to estimate the cyclical component in order to calculate structural net borrowing – i.e. the amount of net borrowing that is independent of cyclical effects. Cyclically induced changes in revenue and expenditure trigger corresponding increases or decreases in the available scope for net borrowing and/or require budget surpluses to be run.

The symmetric operation of automatic stabilisers over the economic cycle prevents additional net borrowing during the downside of the cycle (i.e. when there is a negative output gap) from leading to a systematic buildup of government debt over the long term, because cyclical surpluses are required during the upside of the cycle (i.e. when there is a positive output gap).

Budget rules that are intended to take account of cyclical effects will not work without a definition of what constitutes normal conditions as a point of reference for the economic cycle. Only by calculating the deviations between actual and normal economic conditions is it possible to identify the cyclical effect, to distinguish between the upside and the downside of the cycle, and in this way to determine the amount of cyclical deficits or surpluses. To ensure that the rule is consistent with the European Stability and Growth Pact, the debt brake employs the cyclical adjustment procedure agreed and applied as part of European budget surveillance procedures.

The cyclical component is the product of the output gap (i.e. the difference between actual and potential GDP) and the semi-elasticity of the federal budget. The semi-elasticity parameter indicates how the balance of federal revenues and expenditures changes in response to a change in aggregate economic activity.

The cyclical component is generally calculated twice for one budget: once when the budget is prepared (cf. section 2 of the Article 115 Ordinance), and once when the budget is closed (cf. section 3 of the Article 115 Ordinance). If a supplementary budget is needed, the cyclical component must be calculated anew at such time (cf. section 4 of the Article 115 Ordinance).

The cyclical component used in preparing the budget is calculated by multiplying (a) the estimated output gap for the relevant budget year with (b) the semi-elasticity of the federal budget. The estimate of the output gap is based on official national accounts data as well as the aggregate economic outcomes expected by the Federal Government at the time of preparing the budget (using the findings of the interministerial macroeconomic forecasting group for the short term and the findings from the departmental coordination process for the medium term).

Because the estimate for the output gap is based on macroeconomic data in real terms, but the budgets are recorded in nominal terms, it is also necessary to use the nominal output gap when calculating the cyclical component. In this instance it is assumed that the relative output gap, i.e. the difference between GDP and potential output as a share of the latter, is identical in nominal and real terms. Nominal potential GDP, $Y^*_n$, is nominal GDP, $Y_n$, divided by the sum of 1 plus the relative output gap, OG:

$$PP_n = \frac{Y_n}{1 + OG}$$

The nominal output gap is the difference between nominal actual and potential GDP, $Y_n - Y^*_n$. 
When determining the difference that is to be posted to the control account, the cyclical effect on the budget is to be taken as the basis for calculating the amount of maximum permissible net borrowing. For this purpose, the cyclical component determined at the time of preparing the budget is adapted to actual economic outcomes. The difference between (a) the change in GDP established by the Federal Statistical Office at the time of posting to the control account and (b) the change in GDP expected at the time of preparing the budget is added to the output gap estimated at the time of preparing the budget.

If a supplementary budget is adopted, a similar process is used to recalculate the cyclical component. Here the output gap estimated at the time of preparing the budget is corrected by the amount of the difference between (a) the expected change in GDP for the current fiscal year at the time of preparing the supplementary budget (based on the Federal Government’s updated macroeconomic projection) and (b) the expected change in GDP for the current fiscal year at the time of preparing the budget.

The output gap is not reestimated in line with the method used at the time of preparing the budget because this method is subject to more revision than the actual GDP trend and output gap estimates change every time the estimate is updated.

Financial transactions

Transactions relating to financial assets (receivables and liabilities) are referred to as financial transactions. They consist of revenue and spending not affecting capital formation, e.g. privatisation proceeds (the exchange of equity investment assets for cash receipts) or the granting of loans (disbursement of cash to acquire a receivable). Proceeds from the auctions of publicly owned licences do not count as financial transactions, however.

By adjusting revenue and expenditure for financial transactions (cf. section 3 of the Article 115 Act), Germany’s debt brake is aligned as closely as possible with the definitions laid down in the European System of Accounts (ESA), which apply on the basis of European rules.

This adjustment ensures that privatisation revenues, which were used in the past to fulfil the requirements of the old version of Article 115 of the Basic Law, can no longer serve as a means to comply with borrowing limits. This removes a major inconsistency between the European Stability and Growth Pact and national budget legislation.

To make the debt brake easier to operate, net borrowing is adjusted only for financial transactions that can be taken from the budget directly via the budget groupings of revenues and expenditures.

The following groupings are to be factored out, as financial transactions, from the expenditures that count towards maximum permissible net borrowing:
Acquisition of holdings
- Acquisition of holdings in Germany
- Acquisition of holdings abroad

Loans to the public sector
- Loans to the Federation (central government)
- Loans to the Länder
- Loans to local authorities and associations of local authorities
- Loans to special funds
- Loans to social insurance providers and to the Federal Employment Agency
- Loans to special purpose associations

Loans to other sectors
- Loans to public undertakings and institutions
- Loans to private companies
- Loans to other domestic borrowers
- Loans to foreign borrowers

Conversely, the following groupings are to be factored out, as financial transactions, from the revenues that count towards maximum permissible net borrowing:

Sales of holdings
- Proceeds from the sale of holdings
- Capital repayments

Loan repayments from the public sector
- Loan repayments from the Federation (central government)
- Loan repayments from the Länder
- Loan repayments from local authorities and associations of local authorities
- Loan repayments from special funds

Loan repayments from other sectors
- Loan repayments from public undertakings and institutions
- Other loan repayments from domestic borrowers
- Loan repayments from foreign borrowers

Golden rule

In fiscal policy, the concept of the golden rule is to limit the amount of new public sector borrowing to the level of net public sector investment, i.e. to limit net borrowing to the level of gross capital formation less depreciation and disinvestment. The argument justifying this approach is that net government investment is accompanied by asset formation on the government side, and that this benefits future generations, which means that it is fair for future generations to bear a share of the financing. Behind this lies the idea that productive public investments in themselves increase future potential GDP per inhabitant.
The old version of Article 115 of the Basic Law was geared towards this golden rule to some extent. However, certain aspects of the Basic Law's interpretation of the golden rule were subject to criticism, and rightly so. The primary criticism was the problem of definition. For example, investment was defined as including investment grants to the private sector or abroad. In both of these cases, however, no (direct) net asset growth for the state occurs. Conversely, government consumption sometimes involves expenditures that are like investment – this includes spending on education to increase human capital. Furthermore, the de facto implementation of the golden rule took place on the basis of gross capital formation without taking depreciation into account, for example. This meant that replacement investments could be financed through new borrowing without a corresponding repayment obligation. As a result, the new debt continued to exist even if the capital goods financed in this way no longer existed or did not add new value. Under the growth and investment conditions that existed in Germany, this led to a steadily rising debt-to-GDP ratio that became unacceptable (see Figure 1). This was ultimately the reason for introducing the debt brake. The old version of Article 115 of the Basic Law worked; however, when viewed over the full period of its application, it was not interpreted as an upper limit but was instead exploited. A strict orientation towards net investment would have required balanced budgets or surpluses – at least in Germany from the mid-1990s onwards.

Maximum permissible net borrowing

The amount of maximum permissible net borrowing is generally derived from the structural component less the cyclical component and the balance of financial transactions (see Figure 2 and Figure 3).

If, during an economic upturn, the threshold of 1% of GDP is exceeded on the debit side of the control account, this excess amount (i.e. the difference between the control account's book value and the threshold value) is also to be subtracted from the structural component, but is not to exceed 0.35% of GDP.

The amount of maximum permissible net borrowing also decreases if an exception (see Section I: Background and basic structure – Securing the state's ability to act in emergency situations) was invoked in one of the preceding years and if, in accordance with the amortisation plan, it is necessary to pay down that year's extra new borrowing incurred on top of the amount of maximum permissible net borrowing.

The amount of maximum permissible net borrowing is initially calculated during the budget preparation process. To post the control account entry following closure of the budget, this amount is recalculated using a cyclical component updated on the basis of actual GDP outcomes and the actual balance of financial transactions.
One-off effects

One-off effects are temporary fiscal effects that do not have a lasting influence on the condition of public budgets. Examples of such one-off effects mentioned in the code of conduct for the European Stability and Growth Pact include: the sale of non-financial assets, proceeds from auctions of publicly owned licences, short-term costs caused by natural disasters, tax amnesties, and revenues from the transfer of pension obligations.

In contrast to the calculation of the structural deficit under EU budgetary surveillance procedures, the debt brake does not employ any adjustment for one-off effects. This means, for instance, that proceeds from the auction of a telecommunications frequency, as a non-cyclically induced one-off effect, decrease the structural deficit.

This alternative method to the EU-level approach is justified because no clear and unequivocal definition of the term “one-off effects” exists in such a form in the budget titles. If there were a requirement to exclude one-off effects, this would have posed a risk of abuse.

Furthermore, one-off effects themselves vary in terms of their impact on the structural deficit. The repayment of the commuter tax allowance for 2007 and 2008 is one example of this. In December 2008, the Federal Constitutional Court ruled that the allowance had to be repaid. Treating this repayment as a one-off effect under the debt brake would have lowered structural net borrowing for 2009 (the year in which the repayment affected the cash position in the budget). At the same time, it would have been necessary to raise the structural deficits for 2007 and 2008 retroactively because there would have been a requirement to allocate the repayment to these years. If the debt brake had been applicable at that time, it would have been necessary to adjust the control account accordingly in these years. Such an ex-post booking on the account would, however, be difficult to justify because, from the position of being in 2009, it would no longer have been possible for legislators to react and adjust the 2007 and 2008 budgets, and thus prevent a negative booking on the control account. This example shows that the debt brake’s treatment of one-off effects in a way which differs from the EU procedure is very useful in preventing misuse during the budget preparation process and in ensuring that the control account functions as intended.

Output gap

The output gap (cf. section 5 subsection (2) of the Article 115 Act; section 2 subsection (2) of the Article 115 Ordinance) indicates the difference between actual and potential GDP, i.e. the GDP achievable when production factors are utilised at normal capacity. Potential GDP and hence the output gap are unobservable quantities that are determined using an econometric estimate.

The estimate for the debt brake uses the Cobb-Douglas aggregate production function, in line with the method applied in budgetary surveillance procedures under the European Stability and Growth Pact. The Economic and Financial Affairs Council agreed to this approach as a reference method on 12 July 2002 and on 11 May 2004. The production function models potential output as a combination of labour and capital stock utilised at normal capacity, multiplied by the trend in total factor productivity as a measure of technological progress under normal capacity utilisation.

Public-private partnerships (PPPs)

Budgetary payments for PPP projects are included when determining the Federation’s maximum permissible net borrowing. This means that PPPs are booked differently than in the system of national accounts. The indicators used for European budgetary surveillance are based on the system of national accounts which, in contrast to cash-based financial statistics (of revenues and expenditures, recorded under budget titles), follows the concept of booking e.g. a public good when it is produced and not necessarily when it is paid for.

This methodological difference is not of importance in the case of conventional public construction projects because the associated investment (construction) generally leads directly to expenditure in the budget. In the case of PPPs, however, divergence between construction and payment is a constituent attribute: In an ideal scenario, the private partner constructs and finances the entire project and then operates it over the lifecycle (with PPP projects having up to 30-year contractual lifecycles), while the contracting authority spreads its payments to the private partner evenly over a period of up to 30 years, depending on the duration of the contract. In normal cases, the formation of PPP projects must be recorded as government investment expenditure in the national accounts,\(^3\) which means that the expenditure – like the amount of construction completed – is of immediate relevance to the deficit. Under the debt brake, the relevant figure is the debit in the amount of the payments to the private partner recorded in the budget.

Refraining from further alignment with the Maastricht deficit means the debt rule is easy to apply. There is no need to add or deduct any elements; the debt brake takes expenditure into account in the manner in which it is actually incurred in the budgets (cf. the explanatory memorandum to section 3 of the Article 115 Act). The task of gathering information is also simple and transparent because all of the information (i.e. payments) required to book PPP expenditure are contained in the budget – while under the national accounts method, the expenditure on the construction would have to be taken into account in line with the amount of construction work actually completed.

The debt brake entails divergence from the national accounts approach and this could ostensibly create incentives for the public sector to undertake additional construction. However, the general principle is that the decision to undertake a PPP project can only be made on the basis of efficiency analyses. The form of the booking under the debt brake is not permitted to exert any influence on decisions about the form a project takes (i.e. whether it is executed by the state or as a PPP).

At present, PPP projects have little impact on the government budget management criteria that are the focus of EU budgetary surveillance procedures (i.e. the Maastricht criteria of government budget balance and government debt-to-GDP ratio). Current practices will be subject to review if PPP investments attributable to the state increase to such an extent in the future that they interfere with the functions that the debt brake fulfils – in terms of indicators and governance – as part of EU budgetary surveillance procedures.

\(^3\) One exception would be in cases where it can be clearly shown that, as part of the contractual arrangements, the business risk passes from the state to the private partner.
Safety margin

Given that unexpected structural developments in revenues and expenditures may occur, it may be advisable, during the budget planning process, to provide for a safety margin in relation to the maximum permissible deficit stipulated in the constitution (0.35% of GDP) and to the amount of maximum permissible net borrowing derived from this constitutional limit. The reason is that if the amount of permissible net borrowing has already been used up in the preceding financial planning, unexpected developments in revenues and expenditures could require the inclusion of corresponding consolidation measures at very short notice in the draft budget or at any stage until the budget is ultimately adopted. This is, however, extremely difficult and not desirable because corrective measures may have to be taken in phases of contraction, which then have a procyclical effect.

Against this background, the Deutsche Bundesbank\(^4\) has proposed that the budget preparation process should aim not to achieve structural net borrowing of 0.35% of GDP but rather to achieve a structural surplus, in order to avoid the compulsion to adopt procyclical budget policies due to errors of estimation. In this connection, the Bundesbank points to uncertainties especially with respect to estimating tax revenues and the cyclically induced share of net borrowing.

Semi-elasticity of the federal budget

The semi-elasticity parameter of the federal budget (cf. section 5 subsection (3) of the Article 115 Act; section 2 subsection (3) of the Article 115 Ordinance) measures the cyclically induced change in the ratio between the federal budget’s net lending/borrowing and GDP, when GDP deviates from potential GDP by 1%. The semi-elasticity of the federal budget is derived from the semi-elasticity of the general government budget. It is calculated as the sum of the partial elasticities of the general government budget’s semi-elasticity, weighted with the federal shares of cyclically dependent general government budget revenues and expenditures. This procedure is also used under the budgetary surveillance rules of the European Stability and Growth Pact and was published by the European Union’s Economic Policy Committee.\(^5\) The semi-elasticity of the federal budget has been calculated at a rounded value of 0.205 for the 2015 fiscal year onwards.

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The semi-elasticity of the general government budget is calculated as the sum of the partial elasticities for cyclically dependent taxes, social security contributions and labour market expenditures. Using this method, the semi-elasticity of Germany’s general government budget has averaged 0.55 in recent years, with mild deviations in individual years. This means that a (positive) output gap of 1% of potential GDP (i.e. when the economy is strong) increases the ratio between the general government cyclical balance and GDP by 0.55 percentage points. The semi-elasticity of the federal budget will be adapted to new estimates of the general government budget’s semi-elasticity used in the EU’s procedure.\(^6\)

Social security funds

The Federation bears political responsibility for any deficits in the budgets of social security funds. This is similar to the way in which the budget deficits of local authorities are assigned to the Länder on account of the supervisory control that the Länder maintain over local authorities. The individual branches of the social security system are subject to their own fiscal rules, which are laid down in social policy legislation; however, this legislation also generally provides for balanced budgets. In general, the revenues and expenditures of social security funds are to be balanced without revenue from borrowing, thereby avoiding continual deficits. Temporary deficits that may arise can be financed by drawing on financial reserves, by adjusting contribution rates, or through federal grants. In line with European rules, the fiscal balances of social security funds are included in the general government balance, and they are subject to the general government budget monitoring and coordination procedures carried out by the Stability Council. However, when it comes to constitutional rules on limiting public debt as part of the budget preparation process, it is necessary for both technical and political reasons to restrict the focus to the federal budget:

- If social security fund budgets were to be taken into account as part of the procedures for complying with structural net borrowing requirements during the process of preparing the federal budget, this would add huge information requirements to – and thereby overload – the budget preparation process.
- Within the framework of the European Stability and Growth Pact, general government net borrowing/lending (the Maastricht balance) is calculated using the system of national accounts, which draws on other sources in addition to government budget statistics. National accounts serve the purpose of analysing the economic relations between sectors of an economy, but they are not an instrument for planning.
- For political reasons, parliament cannot be expected to adapt reactively, during the process of preparing the federal budget, to decisions taken by the self-administering bodies of the social security funds.

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To ensure that the Federation’s debt brake is practicable, it needs to restrict itself to the aspects decided directly by the Bundestag. In the case of the budgets for social security funds, the statutory rules already ensure that there are no (lasting) inconsistencies and “errors” in terms of ensuring the sustainability of public finances. The self-regulating effect of adjustments in the rate of contributions to social security funds helps such budgets to remain nearly structurally balanced. Furthermore, it is likely that this self-regulating effect reinforces the viability of the social security system more effectively and transparently than would be the case if social security fund budgets were incorporated into the federal budget.

Special funds

The previous version of Article 115 paragraph (2) of the Basic Law exempted special funds from Article 115 paragraph (1) of the Basic Law. This meant they could be used to create shadow budgets with their own borrowing authorisations, ultimately not subject to any limit.

The new Article 115 of the Basic Law no longer contains any exemptions in this regard. From 2011 onwards, borrowing authorisations for federal special funds fall under the amount of maximum permissible net borrowing together with borrowing authorisations for the core budget. Borrowing authorisations that existed as of 31 December 2010 for already established special funds are not affected by this rule, in accordance with Article 143d paragraph (1) of the Basic Law.

Structural component

The structural component indicates the amount of permissible structural borrowing, i.e. net borrowing adjusted for the balance of financial transactions and the cyclical effect (cyclical component).

The Federal Statistical Office calculates the GDP figure used as the basis for determining permissible structural borrowing. Nominal GDP for the year preceding the preparation of the budget serves as the point of reference (cf. section 4 of the Article 115 Act). The structural component for each fiscal year is conclusively determined at the time when the budget is adopted and applies unchanged for the closure of the budget as well. From 2016 onwards, the structural component is 0.35% of GDP, which translates into approximately €11 billion.

During the transitional period from 2011 to 2015, the structural component is being reduced in equal steps from its 2010 starting value to 0.35% of GDP in 2016 (cf. Article 143d paragraph (1) of the Basic Law; section 9 of the Article 115 Act). The starting value – structural net borrowing for the year 2010 – was specified at the time when the 2011 federal budget was drafted (i.e. in summer 2010) and was only an estimate since the fiscal year had not yet concluded at that time. The expected amount of structural net borrowing in 2010 (€53.2 billion or 2.2% of GDP), which was used as the basis for plotting the reduction increments, was the sum of (a) the amount of actual net borrowing for the 2010 federal budget expected at that time (€65.2 billion), (b) the cyclical component (which at −€12.0 billion was negative in 2010) and (c) the estimated actual balance of financial transactions (€0.03 billion) (see Figure 5). The reduction increments were plotted in linear fashion, which resulted in annual reduction increments of approximately 0.3% of GDP for the transitional period from 2011 to 2016.
**Figure 5: Calculation of 2010 structural net borrowing (in €bn)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net borrowing (as of June 2010)</td>
<td>65.2</td>
</tr>
<tr>
<td>Plus balance of financial transactions</td>
<td>0</td>
</tr>
<tr>
<td>Plus cyclical component (from spring 2010 forecast)</td>
<td>-12.0</td>
</tr>
<tr>
<td>Structural net borrowing</td>
<td>53.2</td>
</tr>
<tr>
<td>Nominal GDP for year preceding budget preparation (from spring 2010 forecast)</td>
<td>2,407.2</td>
</tr>
<tr>
<td>2010 structural net borrowing as % of GDP (starting point for reduction)</td>
<td>2.21</td>
</tr>
<tr>
<td>Annual reduction increments from 2011 onwards, with equally spread increments until maximum permissible net borrowing of 0.35% of GDP is reached by 2016 (as % of GDP)</td>
<td>0.31</td>
</tr>
</tbody>
</table>

Figures may vary due to rounding.

**Supplementary budgets**

In cases where supplements to the Budget Act (cf. section 8 of the Article 115 Act) become necessary due to unforeseeable developments in revenue and expenditure (and where no exceptional circumstances exist in accordance with Article 115 paragraph (2) of the Basic Law), the amount of maximum permissible net borrowing determined at this time may be exceeded by up to 3% of the estimated tax revenue included in the budget. These supplements may not include any new measures that lead to higher expenditures or lower revenue. Only expected economic outcomes are updated for the purpose of calculating the cyclical component.

Regardless of any additional spending that may be permitted in a supplementary budget, the entry to the control account must still show the amount by which actual net borrowing upon closure of the accounts exceeds the amount of maximum permissible net borrowing determined when the budget was first prepared.
III. Legal bases

Article 109 of the Basic Law

(1) The Federation and the Länder shall be autonomous and independent of one another in their budget management.

(2) The Federation and the Länder shall jointly meet the obligations of the Federal Republic of Germany resulting from legal acts of the European Community for the maintenance of budgetary discipline on the basis of Article 104 of the Treaty Establishing the European Community and shall, within this framework, give due regard to the requirements of overall economic equilibrium.

(3) The budgets of the Federation and the Länder shall in principle be balanced without revenues from borrowing. The Federation and Länder may introduce rules intended to take into account, symmetrically in periods of economic expansion and contraction, the effects of cyclical developments that deviate from normal conditions, as well as exceptions for natural disasters or unusual emergency situations that are beyond governmental control and are substantially harmful to the state’s financial capacity. For such exceptions, a corresponding amortisation plan is to be adopted. Details for the budget of the Federation shall be governed by Article 115 subject to the proviso that the first sentence above shall be deemed to be satisfied if revenues from borrowing do not exceed 0.35 percent of nominal gross domestic product. The Länder themselves shall regulate details of their budgets within the framework of their constitutional powers subject to the proviso that the first sentence above shall be deemed to be satisfied only if no revenues from borrowing are permitted.

(4) A federal law requiring the consent of the Bundesrat may establish principles applicable to the Federation and the Länder governing budgetary law, the responsiveness of budgetary management to economic trends, and long-term financial planning.

(5) Sanctions imposed by the European Community in connection with the provisions of Article 104 of the Treaty Establishing the European Community in the interest of maintaining budgetary discipline shall be borne by the Federation and the Länder at a ratio of 65 to 35 percent. In solidarity, the Länder as a whole shall bear 35 percent of the charges incumbent on the Länder according to the number of their inhabitants; 65 percent of the charges incumbent on the Länder shall be borne by the Länder according to their degree of causation. Details shall be regulated by a federal law requiring the consent of the Bundesrat.
Article 115 of the Basic Law

(1) The borrowing of funds and the assumption of sureties, guarantees, or other warranties which may lead to expenditures in future fiscal years shall require authorisation by a federal law specifying or permitting computation of the amounts involved.

(2) Revenues and expenditures shall in principle be balanced without revenues from borrowing. This principle shall be deemed to be satisfied if revenues from borrowing do not exceed 0.35 percent of nominal gross domestic product. In addition, when cyclical developments deviate from normal conditions, effects on the budget in periods of economic expansion and contraction must be taken into account symmetrically. Deviations of actual net borrowing from the upper borrowing limit specified under the first to third sentences above shall be recorded on a control account; debits exceeding the threshold of 1.5 percent of nominal gross domestic product are to be reduced in accordance with the economic cycle. More precise details, particularly with regard to the adjustment of revenues and expenditures for financial transactions and the procedure for calculating the upper limit on annual net borrowing, taking into account economic developments on the basis of a cyclical adjustment method together with the control and balancing of deviations of actual net borrowing from the standard limit, shall be regulated by a federal law. In the event of natural disasters or unusual emergency situations which are outside the control of government and have a major impact on the financial position of the government, these upper borrowing limits may be exceeded on the basis of a decision by a majority of the Bundestag’s members. The decision must be accompanied by an amortisation plan. Repayment of the amounts borrowed under the sixth sentence above must be effected within an appropriate period of time.

Act on the Implementation of Article 115 of the Basic Law (Article 115 Act)

Section 1 – Borrowing authorisations

The Budget Act shall determine the amount up to which the Federal Ministry of Finance may borrow

1. to cover expenditures,
2. to ensure cash payments can continue to be processed in an orderly manner (liquidity loans).

To the extent that these liquidity loans have been repaid, repeated use may be made of the authorisation. Liquidity loans may fall due no later than six months after the end of the fiscal year for which they have been taken out.

Section 2 – Principles for the budgeting of borrowing to cover expenditures

(1) When budgeting revenues and expenditures in normal cyclical conditions, revenues and expenditures shall in principle be balanced without revenues from borrowing; revenues and expenditures shall be adjusted for financial transactions. Borrowing of up to 0.35 percent of nominal gross domestic product shall be permissible as a structural component.

(2) If an economic trend deviating from the normal conditions is expected for the fiscal year, as a cyclical component, the upper limit on revenues from borrowing to be included in the budget under subsection (1) above shall vary by the amount of those revenues from borrowing or by the amount of budget surpluses which corresponds to the expected effect of the economic trend on the budget.
Section 3 – Adjustment for financial transactions

Expenditures for the acquisition of holdings, for repayments of principal to the public sector and for the granting of loans shall be factored out of the expenditures under section 2 subsection (1), first half-sentence; revenues from the sale of holdings, from borrowing from the public sector and from loan repayments shall be factored out of the revenues under section 2 sub-section (1), first half-sentence.

Section 4 – Principles for determining permissible structural borrowing

The Federal Statistical Office shall calculate the gross domestic product used as the basis for determining permissible structural borrowing in accordance with section 2 subsection (1), second sentence. The nominal gross domestic product for the year preceding the preparation of the budget shall serve as the reference.

Section 5 – Cyclical component

(1) The amount of the cyclically induced revenues from borrowing or budget surpluses to be included in the budget in accordance with section 2 subsection (2) shall be derived from the expected cyclical deviation from normal cyclical conditions.

(2) A cyclical deviation from normal cyclical conditions shall be deemed to exist if an under-utilisation or over-utilisation of aggregate productive capacities is expected (output gap). This shall be the case if the potential gross domestic product to be estimated on the basis of a cyclical adjustment method deviates from the expected gross domestic product for the fiscal year for which the budget is prepared.

(3) The cyclical component shall be calculated as the product of the output gap and budget sensitivity which expresses how the revenues and expenditures of the Federation change when aggregate economic activity changes.

(4) In agreement with the Federal Ministry of Economics and Technology, the Federal Ministry of Finance shall, by means of a statutory instrument and without the consent of the Bundesrat, stipulate the details of the procedure for determining the cyclical component in conformity with the cyclical adjustment method applied within the framework of the European Stability and Growth Pact. The procedure shall be reviewed and developed further on a regular basis taking the current state of knowledge into account.

Section 6 – Exceptional situations

In the event of natural disasters or unusual emergency situations which are outside the control of government and have a major impact on the financial position of the government, the borrowing limits under section 2 may be exceeded on the basis of a decision by the Bundestag in accordance with Article 115 paragraph (2), sixth sentence, of the Basic Law. This decision must be combined with an amortisation plan. Repayment of the amounts borrowed under the first sentence above must be effected within an appropriate time frame.
Section 7 – Control account

(1) Where actual borrowing deviates from the amount which, at the end of the relevant fiscal year, is arrived at as the upper limit under section 2 on the basis of the actual cyclical effect on the budget, this deviation shall be posted to a variance account (control account). To the extent that exceptional circumstances in accordance with Article 115 paragraph (2), sixth sentence, of the Basic Law have been invoked, the amount to be posted shall be adjusted for the increased net borrowing as a result of the corresponding decision. The deviation to be posted shall be determined annually on 1 March of the year following the fiscal year in question and updated over the further course of the year, for the final time on 1 September of the year following the fiscal year in question.

(2) Where the balance is negative, steps shall be taken to balance the control account. The control account's negative balance is not to exceed a threshold of 1.5 percent of nominal gross domestic product. The GDP figure to be applied shall be determined in accordance with section 4.

(3) Where the control account’s balance is negative and where the amount of the balance exceeds 1 percent of nominal gross domestic product, the borrowing authorisation under section 2 subsection (1), second sentence, shall decrease in the next year respectively by the excess amount, but not exceeding 0.35 percent of nominal gross domestic product; the decrease shall become effective only in years when there is a positive change in the output gap.

Section 8 – Rights of deviation in the case of supplements to the Budget Act and to the budget

In the case of supplements to the Budget Act and to the budget, the amount of permissible net borrowing calculated under section 2 subsection (1), second sentence, may be exceeded up to the amount of 3 percent of the tax revenues included in the budget. These supplements may not include any new measures that lead to higher expenditures or lower revenue. Only expected economic outcomes shall be updated for the purpose of calculating the cyclical component. The provisions of section 7 shall remain unaffected.

Section 9 – Transitional arrangement

(1) This Act shall be applied for the first time to the federal budget for the year 2011.

(2) Section 2 subsection (1) shall apply during the period from 1 January 2011 to 31 December 2015 subject to the proviso that the structural deficit for the 2010 fiscal year is reduced in equal steps from 2011 onwards.

(3) Section 7 shall apply subject to the proviso that the control account’s cumulative balance for fiscal years 2011 to 2015 is reset to zero with effect from 31 December 2015.
Ordinance on the Procedure for Determining the Cyclical Component under Section 5 of the Article 115 Act (Article 115 Ordinance)

On the basis of section 5 subsection (4), first sentence, of the Article 115 Act of 10 August 2009 (Federal Law Gazette I, p. 2702, 2704), the Federal Ministry of Finance, in agreement with the Federal Ministry of Economics and Technology, orders as follows:

Section 1 – Purpose of this Ordinance

This Ordinance shall govern determination of the cyclical component in the case of preparing the federal budget under section 2 subsection (2) of the Act, in the case of supplements to the Budget Act under section 8, third sentence, of the Act, and following the end of the fiscal year under section 7 subsection (1), first sentence, of the Act.

Section 2 – Determining the cyclical component in the case of preparing the budget

(1) The cyclical component for preparation of the budget (section 2 subsection (2) of the Act in conjunction with section 5 of the Act) shall be calculated by multiplying the output gap determined under subsection (2) below with the budget sensitivity determined under subsection (3) below.

(2) To determine the output gap as the difference between actual and potential GDP (section 5 subsection (2) of the Act), the potential GDP which corresponds to the GDP achievable when production factors are utilised at normal capacity shall be estimated. The estimate shall use the Cobb-Douglas aggregate production function, in line with the method applied in budgetary surveillance procedures under the European Stability and Growth Pact. The production function models potential output as a combination of labour and capital stock utilised at normal capacity, multiplied by the trend in total factor productivity as a measure of technological progress under normal capacity utilisation.

(3) The budget sensitivity (section 5 subsection (3) of the Act) shall cover the cyclically induced change in the Federation’s financial balance in relation to GDP if GDP deviates from potential GDP by one percent. Budget sensitivity shall be calculated as the sum, weighted with the federal shares of the cyclically dependent general government budget revenues and expenditures, of the partial elasticities of the general government budget sensitivity which is also used in the budgetary surveillance method under the European Stability and Growth Pact.

(4) The data for determining the cyclical component shall be the national account figures from the Federal Statistical Office as well as the current macroeconomic forecast by the Federal Government for the short and medium term.

Section 3 – Determining the cyclical component after closing the budget

When determining the deviation to be posted to the control account under section 7 of the Act, the cyclical effect on the budget shall be taken as the basis for calculating permissible net borrowing (cyclical component after closing the budget). For this purpose, the cyclical component determined at the time of preparing the budget under section 2 shall be adjusted for actual economic outcomes by correcting, for the respective fiscal year, the output gap which was determined at the time of preparing the budget. The correction shall be made on the basis of the difference between the change in gross domestic product established by the Federal Statistical Office at the time of posting the entry to the control account and the change in gross domestic product expected at the time of preparing the budget.
Section 4 – Determining the cyclical component in the case of supplements to the Budget Act

In the case of supplements to the Budget Act under section 8, third sentence, of the Act, the cyclical component determined under section 2 at the time of preparing the budget shall be adjusted to the (meanwhile modified) estimate of the aggregate economic trend for the fiscal year by correcting the output gap determined at the time of preparing the budget by the amount of the difference between the expected change in GDP for the current fiscal year at the time of preparing the supplementary budget and the expected change in GDP for the current fiscal year at the time of preparing the budget.

Article 143d of the Basic Law

(1) Articles 109 and 115 in the version in force until 31 July 2009 shall be applied for the last time to the 2010 budget. Articles 109 and 115 in the version in force as from 1 August 2009 shall apply for the first time to the 2011 budget; borrowing authorisations existing on 31 December 2010 for special funds already established shall remain unaffected. In the period from 1 January 2011 to 31 December 2019, the Länder may, in accordance with their applicable legal regulations, deviate from the provisions of paragraph (3) of Article 109. The budgets of the Länder are to be prepared in such a way that the 2020 budgets fulfil the requirements of Article 109 paragraph (3), fifth sentence. In the period from 1 January 2011 to 31 December 2015, the Federation may deviate from the requirements of Article 115, paragraph (2), second sentence. The reduction of the existing deficit should begin with the 2011 budget. The annual budgets are to be prepared in such a way that the 2016 budget satisfies the requirements of Article 115 paragraph (2), second sentence; details shall be regulated by federal law.

(2) To assist them in complying with the requirements of Article 109 paragraph (3) from 1 January 2020 onwards, the Länder of Berlin, Bremen, Saarland, Saxony-Anhalt, and Schleswig-Holstein may receive, for the period from 2011 to 2019, consolidation assistance totalling €800 million annually from the federal budget. The respective amounts are €300 million for Bremen, €260 million for Saarland, and €80 million each for Berlin, Saxony-Anhalt, and Schleswig-Holstein. The assistance shall be provided on the basis of an administrative agreement in accordance with a federal law requiring the consent of the Bundesrat. The assistance shall be granted on the condition that the financial deficits must be completely eliminated by the end of 2020. The details, especially the annual reduction increments for the financial deficits, the Stability Council’s monitoring of the reduction of financial deficits as well as the consequences entailed in case of non-compliance with reduction increments, shall be regulated by a federal law requiring the consent of the Bundesrat and by an administrative agreement. There shall be no simultaneous granting of consolidation assistance and budget rehabilitation assistance on the basis of an extreme budgetary emergency.

(3) The financial burden resulting from the granting of the consolidation assistance shall be borne equally by the Federation and the Länder, to be financed from their share of value-added tax revenue. Details shall be regulated by a federal law requiring the consent of the Bundesrat.