



Federal Ministry
of Finance

Problems of implementing an expenditure rule in the preventive arm of the SGP in a federal state

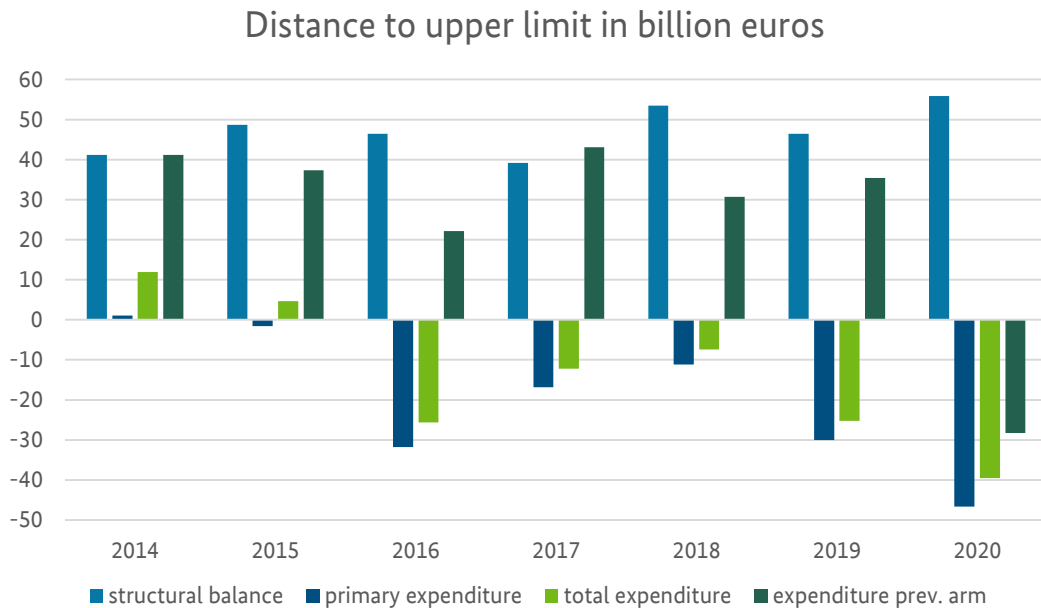
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How would an expenditure rule have worked in the past?

Comparison of ceiling of structural balance with three expenditure rules:

- Difference of potential growth to growth of
 - Primary expenditure (=excl. interest expenditure) net of DRM (1)
 - Total expenditure net of DRM (2)
- Difference between expenditure benchmark and growth in expenditure under the currently valid preventive arm (3)



→ Room for manoeuvre in the general government budget in all three variants in the years 2014 to 2020 lower than when considering the MTO alone as the upper limit for the general government deficit.

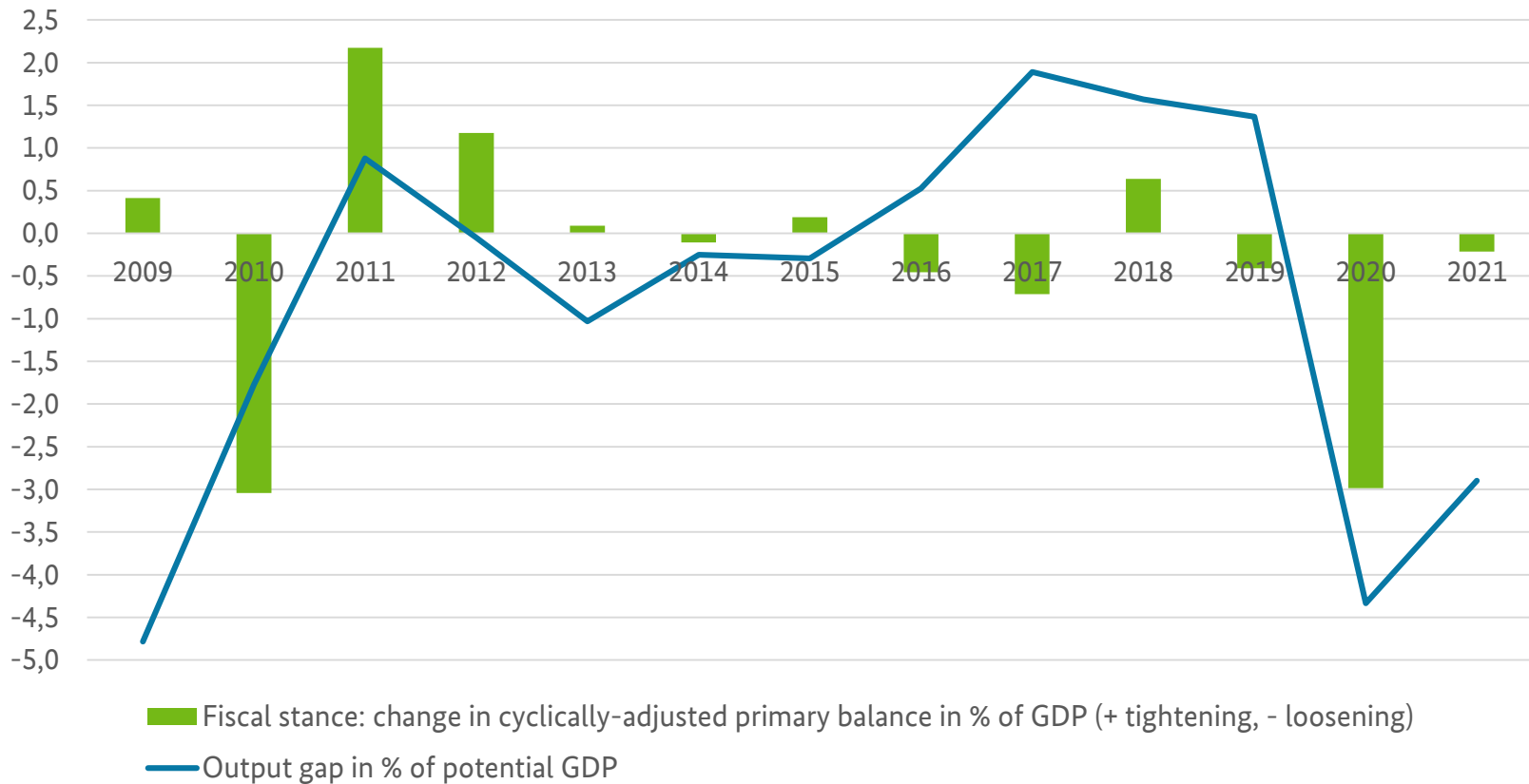
Would an expenditure rule be less procyclical?

- Expenditure rule would have been more restrictive in „good times“

BUT:

- Only a small part of the room for manoeuvre that would have resulted from the gap to the MTO was used.
 - Reason: the high surpluses only emerged during budget execution due to higher tax revenues than estimated and lower interest expenditure than budgeted.
- Expenditure rule probably would not have lead to different fiscal policies.
- A more restrictive fiscal rule might have had an additional unintended dampening effect on infrastructure investment.
- Primary expenditure rule would also be problematic for previous practice of prudent budgeting of interest expenditures.

German fiscal policy was mostly not pro-cyclical before the COVID-19 pandemic

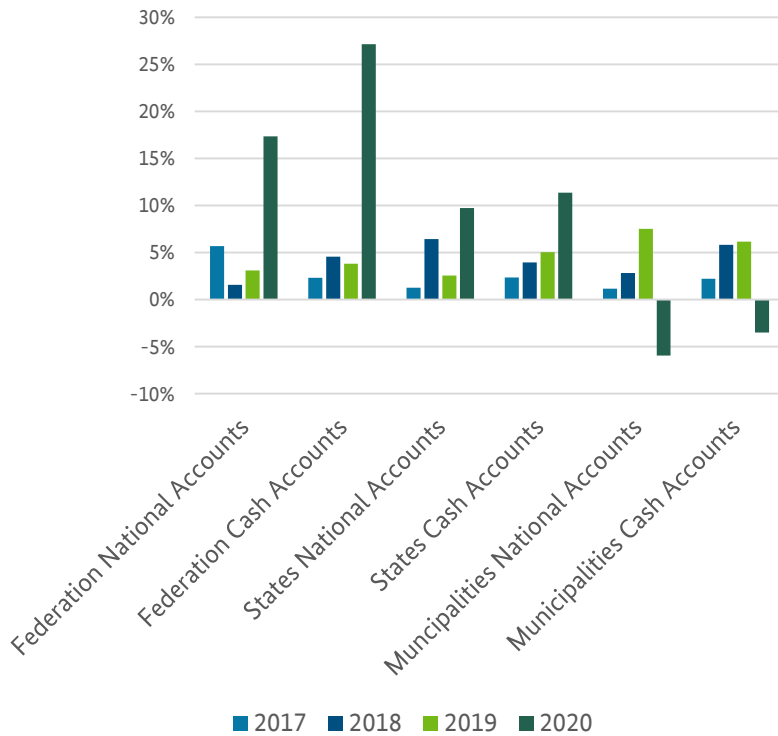


How could an expenditure rule be implemented in a federal state?

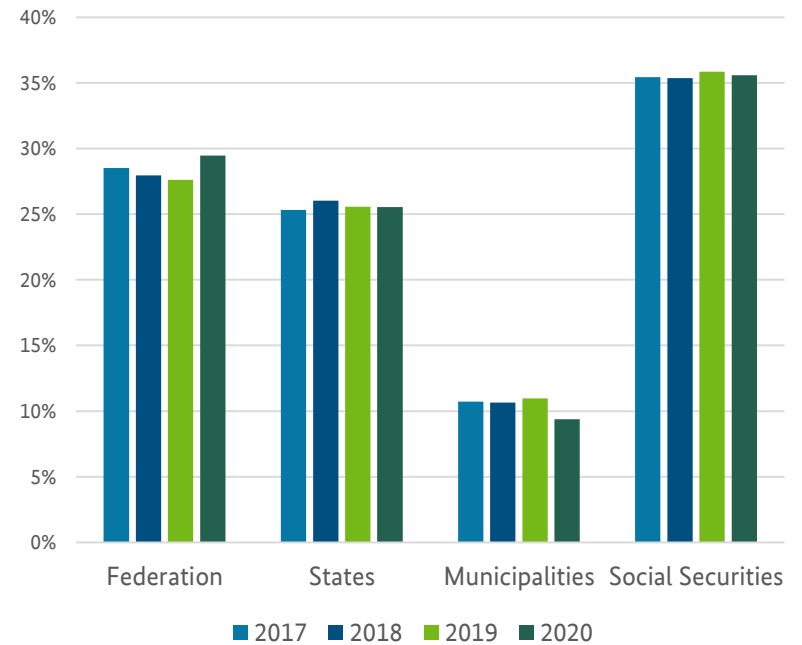
- Due to the financial interdependencies between the federal, state, local and social security levels of government, the expenditures of the individual levels cannot be added to the total general government expenditure.
- Negotiations would be required with the Länder (including municipalities) on the question of which government expenditures are to be allocated to which level and how to distribute the expenditure ceiling to different government levels.
- Net expenditure would be decisive: defined as expenditure of one level of government minus revenue from other levels of government.
- Not sure to what extent a strengthening of the expenditure rule and a weakening of the focus on the structural balance can be reconciled with the COM objectives of "simplification" and "stronger national ownership".

Is an expenditure rule easier to control?

Different types of net expenditure
- in % yoy -



Net expenditure national accounts in %
of total general expenditure



Compatibility with the debt brake in the Basic Law

- Structural balance is anchored in the debt brake of the Basic Law and in the Fiscal Compact
- Introduction of debt brake among other things to have similar target system in federal budget policy as in preventive arm of European SGP
- Introduction of an expenditure rule could call German debt rule into question and create pressure to introduce an expenditure rule nationally as well
- Goal of the coalition agreement to maintain the constitutional debt brake would be jeopardized