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THE DEBT BRAKE AFTER THE FEDERAL CONSTITUTIONAL COURT JUDGEMENT: INCREASE FLEXIBILITY – MAINTAIN STABILITY

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Executive Summary

Following the ruling of the Federal Constitutional Court on the Second Supplementary Budget Act 2021, the debt brake must be interpreted much more narrowly than previously practised by the Federal Government. In particular, no credit authorisations can be transferred to special funds for use in subsequent years if the emergency exception clause has been applied. After the emergency situation, therefore, either consolidation must take place immediately or an emergency situation must be re-established in subsequent years.

The aim of the debt brake is to ensure the sustainability of German public finances. In its current form, however, the debt brake is more rigid than it would be necessary to maintain (debt) sustainability in Germany. In light of the Federal Constitutional Court's clarification on the interpretation of the debt brake and the resulting stronger restrictions for fiscal policy following an emergency, a reform of the debt brake should be considered.

A pragmatic reform could increase the flexibility of fiscal policy by adapting three elements of the debt brake without jeopardising stability. First, a transitional phase should be introduced in the years immediately after the application of the debt brake's

exception clause. During this phase, the permissible structural deficit could be above the regular limit, but would have to be steadily reduced. Second, the limit for the annual structural deficit should be staggered depending on the level of the debt ratio. The limit could be designed in such a way that higher structural deficits are permitted if the debt ratio is below a certain threshold and the previous deficit limit applies if the debt ratio is above [this threshold]. Thirdly, cyclical adjustments should be less susceptible to revisions through methodological improvements in the estimation of potential output.

Potential courses of action

- Introduce a transition phase for the years immediately following the application of the debt brake's exception clause.
- Increase the structural deficit limit of the debt brake when debt ratios are low.
- Make cyclical adjustments less susceptible to revisions.

Introduction

The judgement of the Federal Constitutional Court (BVerfG, 2023) on the Second Supplementary Budget Act 2021 has clarified some fundamental questions regarding the exception clause of the debt brake enshrined in the Basic Law. The judgement states that the budgetary principles of yearly budgeting (Jährlichkeit) and annuality (Jährigkeit) also apply to the exception clause of the debt brake. This means that credit authorisations established within the scope of the exception clause can only be used until the end of the relevant financial year and then expire without replacement. The Federal Government's practice of recording credit authorisations from years with an emergency situation (2020 to 2022) in special funds and using them to borrow in subsequent years (2023 to 2027) has thus been declared void. This clarification implies that the debt brake must be interpreted much more narrowly than was common practice and that no borrowing authorisations in special funds can be used for the years following an emergency situation. If an emergency situation cannot be declared again for the 2024 financial year – as has been done for 2023 following the judgement – consolidation must now take place more quickly than previously assumed. [↘ BOX 1](#)

The aim of the debt brake is to ensure the sustainability of German public finances. The concept of sustainability describes the extent to which the government's scope for spending is affected by the servicing of government debt. The sustainability of government debt is impaired if an ever-increasing proportion of government spending has to be used for servicing government debt. In extreme cases, the government can no longer fulfil its financial obligations.

However, fiscal rules are subject to various conflicting political and economic problems: The central problem is that decision-makers tend to resolve current distributional conflicts at the expense of those who are not currently part of their electorate. As a result, burdens are shifted into the future (present bias). Firstly, this can lead to insufficient financial buffers being built up outside times of crisis in order to cope with future crises. Secondly, there is a risk that this results in the burden of financing current expenditure being shifted excessively into the

future through credit financing (deficit bias). This can impair sustainability. Thirdly, political decision-makers therefore tend to give too little weight to the welfare of future generations. They make too few expenditures that will only pay off in the distant future (anti-investment bias).

The debt brake serves to limit excessive debt financing of the budget. It therefore addresses the first and second politico-economic problem. However, it does not address the third politico-economic problem of what type of expenditure is financed by debt. How this can be achieved is the subject of controversial debate. This policy brief focuses on modifications to the debt brake that take account of economic dynamics and fiscal policy realities and relate to fiscal variables such as the limit for the annual deficit and the cyclical component.

The focus here is on debt sustainability, which is based on the relationship between the deficit and the debt ratio. It does not address how long-term challenges for the sustainability of public finances (fiscal sustainability) are solved in order to comply with the deficit limits.¹ These result from trends such as demographic ageing or climate change. As long as measures in other policy areas, such as migration, labour market and social policy or economic and energy policy, do not lead to long-term adjustments in public spending and revenue to meet these challenges, they may be reflected in unfavourable developments in public finances.

Ensuring the sustainability of German public finances is not only in the national interest. Against the backdrop of high debt ratios in the euro area and Germany's function as an anchor of stability in the European Monetary Union, it is important that the sustainability of German public finances continues to be ensured in the long term. In view of the current global political situation, it is to be expected that crisis situations will continue to occur in the coming years. In the future, fiscal space will decrease due to demographic developments and the foreseeable increases in demographic-related public spending, which will burden the federal budget primarily through the annual contributions to the public pension scheme and other social security funds. Nevertheless, the debt brake in its current form is more rigid than would be necessary for the sustainability of German public finances. Despite

¹ The European Commission (2023) applies a comprehensive framework for analysing sustainability in the short, medium and long term.

several severe crises and temporarily high deficits, the general government debt ratio is currently 64.4 % of gross domestic product (GDP) (GCEE forecast for 2023), only slightly above the 60 % limit required by the Maastricht Treaty, with a downward trend (GCEE Annual Report 2023 item 70). The International Monetary Fund (IMF, 2023) has forecast a debt ratio of just 57.5 % of GDP for 2028, even taking into account the planned borrowing of the previous special funds. In its current form, the debt brake only allows a structural deficit² for the federal government of 0.35 % of GDP, regardless of the current debt ratio and the assessment of Germany's debt sustainability, thereby restricting the possibility of potentially necessary future-oriented public spending more than necessary.

Modifications to the debt brake should be considered in light of the fact that the debt brake has to be interpreted more narrowly in the future than in the past, the possible restrictions on fiscal policy following an emergency and the low sustainability risks. At the same time, it is important to avoid increased uncertainty about the fiscal policy direction in the coming years, as this could make private households hold back on consumption and companies hold back on investment or even shift investment abroad.

A reform of the debt brake should fulfil two conditions. First, the design should be economically sound and thus take into account incentive mechanisms as well as macroeconomic dynamics. Second, German fiscal rules should be in line with EU-level fiscal rules and the new regulation proposed by the finance ministers of the EU member states in December 2023 (Council of the European Union, 2023). This relates in particular to the question of whether one of these sets of rules defines significantly tighter limits than the other. It should be noted that reforms to the debt brake require a two-thirds majority to amend the Basic Law, which presupposes a broad political consensus.

A pragmatic reform that fulfils these conditions could adjust three elements of the debt brake. This would expand – to varying degrees – the flexibility of fiscal policy without jeopardising the sustainability of public finances. First, a transitional phase could be introduced in the years immediately following the application of the debt brake's exception clause. In these years, the permitted structural deficit could be above the regular limit, but would have to be brought closer to it from year to year. This regulation would be similar to the gradual adjustment when the debt brake was originally introduced or the adjustment path to the structural deficit target ("medium-term objective") of the earlier European fiscal rules. Second, the very rigid limit for the annual structural deficit of 0.35 % of GDP could be made dependent on the level of the debt ratio. The limit could be staggered so that higher deficits are permitted for lower debt ratios, while the current low structural deficits apply for higher debt ratios. Third, the cyclical adjustment could be adapted through methodological changes in order to make the cyclical component less susceptible to revision.

Since the judgement of the Federal Constitutional Court, the need to reform the debt brake has been subject of controversial debate. Critics of a reform fear that this could lead to demands for further easing (GCEE Annual Report 2021 item 228). On the other hand, even without a reform, the very narrow interpretation of the debt brake required by the judgement of the Federal Constitutional Court could weaken its de facto binding nature in the future, for example by declaring emergencies at ever shorter intervals.

The members of the GCEE are assessing certain publicly discussed reform proposals for the debt brake differently regarding their economic impact and political feasibility. However, the Council members agree that the reform steps described in this policy brief represent substantial improvements compared to the status quo.

↳ BOX 1

Implications of the judgement on the Second Supplementary Budget Act 2021

The Federal Constitutional Court has ruled that the debt brake's exception clause cannot be used to provide special funds with credit authorisations in advance and use them in the years following an emergency-related suspension of the debt brake. The budget deficits planned for 2023 and 2024 in excess of the regular limit of the debt brake were possible because the Bundestag recognised an

² The structural deficit is adjusted for cyclical influences and financial transactions.

extraordinary emergency due to the coronavirus pandemic and later the Russian war of aggression on Ukraine and applied the exception clause to the debt brake (Deutscher Bundestag, 2020a, 2020b, 2022). However, the use of credit authorisations in subsequent years contradicts the budgetary principle of annuality. This means that a total of at least 60 billion euros from the Climate and Transformation Fund (KTF) will no longer be available in the years 2024 to 2027. The same applies to the funds from the Economic Stabilisation Fund (WSF) and the "2021 Reconstruction Aid" to deal with the consequences of the flood disaster in 2021. The shortfall could be somewhat lower, for example due to lower utilisation of the special funds or higher than planned revenue from CO₂ pricing. Estimates by ifo (2024) and Boysen-Hogrefe and Groll (2024) assume a funding gap of between 19 and 21 billion euros.

This means that the Federal Government urgently needs to take action. For 2023, the exception clause of the debt brake has again been applied to the funds disbursed by the WSF and the 2021 Reconstruction Aid fund in order to set up a constitutional budget (Deutscher Bundestag, 2023). In the coming years, federal budgets will now have to be set up without the credit authorisations from the special funds. The Federal Government has agreed on a package of measures for 2024. In addition, the medium to long-term financing structure of the federal budget must be reconsidered.

New transitional provision after application of the exception clause

When applying the exception clause due to an emergency situation, the federal government is not limited by the debt brake in the respective year regarding the amount of new debt. However, the additional debt must be related to the emergency situation. Immediately after the end of the year for which an emergency situation has been declared, the regular limits of the debt brake fully apply again, unless the emergency situation can be declared again. However, this is only possible if there is still a significant burden on the federal budget due to the crisis situation. Yet, crises often continue to have a noticeable impact even after their primary cause has been overcome. The consolidation required to comply with the debt brake could provide negative impulses that are unnecessarily strong for an economy that is still struggling (GCEE Annual Report 2021 item 225). In addition, an important instrument in combating the crisis is to stabilise expectations and give economic players security for their planning. Fiscal space may be necessary for this even after the immediate macroeconomic shock. It could therefore be useful to supplement the exception clause with a transitional provision. This would define an orderly gradual reduction of the structural deficit to the regular limit (GCEE Annual Report 2020 item 222).

When the debt brake was introduced, such a transitional phase helped to ensure that the consolidation process was gradual and therefore moderate. The debt brake was adopted in 2009 in the wake of the financial and economic crisis. Due to the considerable strain on public finances at the start of the debt brake in 2011, the upper limit for net borrowing of 0.35 % of GDP for the federal government did not apply until 2016. Until then, the structural deficit of the 2010 budget year had to be reduced in steps of equal size (BMF, 2022). The deficit was in fact reduced in the years after 2010 and even surpluses were attained. [↘ CHART 1 LEFT](#) This, together with continuous GDP growth, noticeably reduced the government's debt-to-GDP ratio until the start of the coronavirus pandemic in 2020. [↘ CHART 1 RIGHT](#)

The transition following the application of the exception clause could provide for a reduction in the structural deficit of at least 0.5 percentage points per year based on the current EU fiscal rules. According to the proposal by the finance ministers of the EU member states, the EU's future fiscal rules will be similar (Council of the European Union, 2023). Measures that are necessary to achieve the deficit limits will be spread over four years. As before, the requirements for the actual deficit reduction could be linked to the output gap, i.e. the percentage deviation of GDP from potential output, and the current debt level (European Commission, 2019). A less complex regulation could provide for

a linear reduction in structural net borrowing to the level applicable in normal times within three years after the exception clause had been applied (Kooths, 2023).

The introduction of a transitional phase would open up additional fiscal space but, depending on how it is structured, it would also increase the repayment obligations. At the same time, however, it could strengthen the debt brake. After an emergency, crisis-related support measures could be gradually reduced without weakening growth or soliciting/provoking repeated discussions of the declaration of an emergency. This could avoid a possible dilution of the debt brake, especially if it reduces the likelihood that emergencies are declared again and again.

Debt-dependent deficit limits

Determinants of the debt ratio

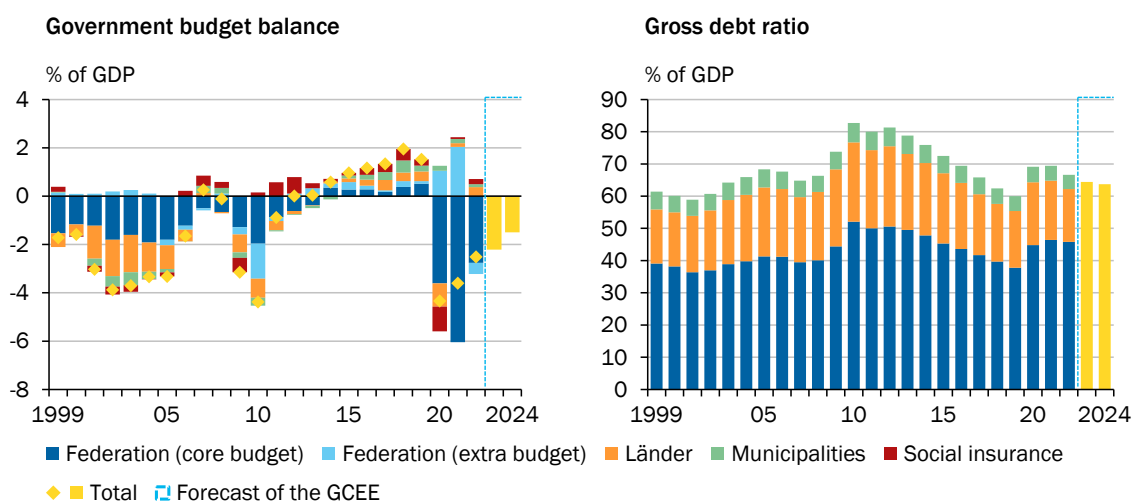
Exogenous events can raise the debt-to-GDP ratio to a significantly higher level within a short period of time, such as at the beginning of the coronavirus pandemic with an increase in the debt-to-GDP ratio of almost 10 percentage points. This can increase the interest burden and reduce fiscal space. It therefore makes sense to keep the debt-to-GDP ratio sufficiently below a critical level for sustainability. The critical level for sustainability depends largely on the development of three variables: the long-term real interest rate, potential growth and

the government primary balance (GCEE Annual Report 2020 box 12). With higher potential growth rates or a lower long-term interest rate, higher debt ratios are sustainable (Furman and Summers, 2020; Blanchard, 2022). Taken together, these three variables can only be predicted with a high degree of uncertainty for a longer time horizon. Additionally, the structure of debt management, in particular the maturity of government debt (Nöh, 2019) is a determinant of debt sustainability.

For reasons of practicability, fiscal rules should continue to be based on limits for deficits and debt ratios. The focus on deficit and debt ratios is widespread despite their imperfect informative value regarding sustainability, as both variables are easy to observe. Fiscal rules based on interest rates or interest expenditure could address sustainability more precisely, but are more difficult to implement. For one thing, these variables fluctuate more strongly. Secondly, they do not only depend on fiscal policy. For example, it would be problematic to rely on a favourable relationship between interest rates and potential growth to ensure sustainability (GCEE Annual Report 2021 items 102 ff.). An abrupt rise in interest rates in relation to growth can quickly jeopardise sustainability on a massive scale. The extremely low interest rates in the 2010s have significantly reduced the interest expenditure of many countries, including Germany. However, the rise in interest rates by more than 2 percentage points in the past two years has significantly worsened the

↘ CHART 1

Government budget balance and gross debt-to-GDP ratio in Germany



outlook for the development of interest expenditure (Grimm et al., 2023). The federal government's interest expenditure in relation to GDP is therefore likely to roughly double compared to 2021 and roughly triple by 2027, assuming interest rates remain the same (Grimm et al., 2023). If the debt ratios in Germany do not rise very sharply, interest expenditure is likely to result in significant budgetary burdens, but not in sustainability problems. On the other hand, falling interest rates would ease the budgetary situation.

Current deficit limit particularly cautious

The debt brake's structural deficit limit of 0.35 % of GDP for the federal budget is more restrictive than the European fiscal rules, which, unlike the German debt brake, do not relate to the federal level but to the general-government deficit (Deutsche Bundesbank, 2022).³ In the current version, European rules allow a structural general-government deficit in the amount of their country-specific medium-term objective (MTO), a maximum of 0.5 % of GDP with a debt ratio above 60 % of GDP. Structural deficits of 1 % of GDP are possible below the 60 % limit. According to the proposal by the finance ministers, the EU's future fiscal rules provide for a target value for the structural deficit of 1.5 % of GDP. For Germany, the MTO is currently 0.5 % of GDP.

The debt brake limits the financing deficit and is not directly aimed at limiting the debt-to-GDP ratio. However, simulations can be used to show how the debt ratio will evolve over the next few decades if the debt brake is observed throughout. An inflation target of 2 % and real GDP growth in line with the GCEE's projection of potential output is assumed (GCEE 2023 item 101). On average, nominal GDP would therefore grow by around 2.7 % per year over the next few decades. Specifically, real GDP growth increases from around 0.4 % in 2024 to 0.8 % by 2040. In the following years, growth declines by around 0.1 percentage points before rising to 1 % by 2070. It is also assumed that the cyclical component is zero due to its symmetrical structure. In the first step, it is assumed that net borrowing of 0.35 % of GDP is fully utilised each year and that no further

loans are taken out during the entire period, for example due to an emergency. The debt ratio would then fall below 60 % of GDP in 2028 and below 30 % of GDP from 2066 onwards. [↘ CHART 2 LEFT](#)

In the next step, it is assumed that the regular limits of the debt brake are exceeded in emergency situations. In the simulations shown, the deficit amounts to 3 % instead of 0.35 % of GDP in 20 % of cases. This calibration is roughly based on experience since the debt brake came into force. This means that the government is in an emergency situation in around every fifth year. An emergency situation can also occur in two consecutive years. This would correspond to a two-year emergency situation, which, however, occurs less frequently. The debt-to-GDP ratio also falls in such a scenario. In 95 % of all paths simulated for this scenario, it falls below 60 % of GDP by 2042. As a median result, the debt-to-GDP ratio falls below 60 % of GDP by 2031 and to just under 42 % of GDP by 2070. In the long term, it converges towards around 30 % of GDP according to the simulation.

A pragmatic proposal: Debt-dependent deficit limits

Deficit limits that depend on the debt ratio could moderately expand fiscal flexibility without jeopardising sustainability. The GCEE therefore proposes adapting the structural deficit limits to the EU fiscal rules currently in force. This would result in a deficit limit of 1 % of GDP if the general government debt ratio is below 60 % of GDP. If the debt ratio is above 60 %, the rule should stipulate a lower deficit of 0.5 % of GDP. The Deutsche Bundesbank (2022) mentions the same limits in its reform proposal with reference to the EU rules. As a further safety line, the deficit should be limited to 0.35 % of GDP if the debt-to-GDP ratio exceeds 90 %. These limits would apply to the federal budget, while the EU fiscal rules relate to the general-government level. However, the federal states are not allowed to incur structural debt, social security funds are not allowed to incur debt at all and local authorities are only allowed to incur debt to a very limited extent. Therefore, the

³ As the federal states in Germany are generally required to have a structurally balanced budget, the social security funds are not allowed to take out loans and the municipalities are also subject to strict debt limits, the general government deficit and the federal deficit are generally not far apart. However, the difference can be greater in single years (Deutsche Bundesbank, 2022).

debt brake should not generally conflict with the EU-level rules (Deutsche Bundesbank, 2022).

A reform proposal with debt-dependent deficit limits and a three-year transitional phase that demands a linear reduction of deficits reduces the debt-to-GDP ratio to a smaller extent each year than current rules, but still leads to a reduction in the medium term under the assumptions made. [↪ CHART 2 RIGHT](#) The average debt-to-GDP ratio is expected to fall steadily to 59 % of GDP by 2070 despite the regular occurrence of emergencies assumed here. In the long term, the debt ratio converges to 56 % of GDP according to the simulation. This proposal would still establish debt reduction paths that are sufficiently rapid. Even if the debt ratio increases due to rising interest rates, there would still be a sufficient safety margin to a critical level for sustainability. Stricter deficit limits associated with higher debt ratios would prompt the Federal Government to curb the spending path. This should ensure the sustainability of public finances.

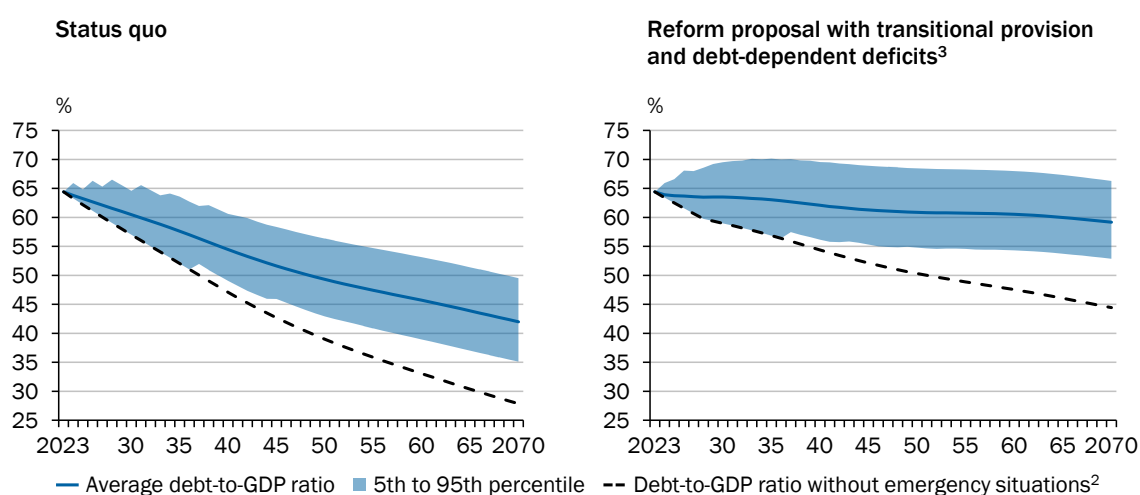
At the same time, the federal government's scope for running deficits increases, which should be used for future-oriented expenditure, for which suitable

incentive mechanisms should be developed. With a deficit limit of 0.35 % of GDP, a structural deficit of 12.6 billion euros is possible in 2023. With a limit of 0.5 % or 1 % of GDP in the event of a debt ratio below 60 % of GDP, structural debt could amount to 5.4 or 23.4 billion euros more per year than at present. Based on the debt ratio forecast by the IMF for Germany, the scope for cumulative structural debt would increase by 57.5 billion euros by 2027 compared to the previous deficit limit of 0.35 % of GDP if nominal GDP remains unchanged: by 5.4 billion euros in 2024 and 2025 and by 23.4 billion euros in 2026 and 2027, when a debt ratio of below 60 % of GDP is forecast.

Sensitivity analyses show how the debt-to-GDP ratio develops under assumptions that are more and less favourable. If emergencies occur less frequently or if nominal GDP grows faster, the debt-to-GDP ratio falls more sharply than under the baseline assumptions. [↪ CHART 3 LEFT](#) On the other hand, the debt-to-GDP ratio is higher than in this scenario if emergencies occur more frequently or if the deficit gets higher in emergency situations. [↪ CHART 3 RIGHT](#) Still,

[↪ CHART 2](#)

Limiting the general government debt-to-GDP ratio through the debt brake¹



1 - The simulations are based on the projections of the German Council of Economic Experts for the debt-to-GDP ratio in 2023 and the growth of real potential output until 2070 (GCEE Annual Report 2023 items 70 and 101). In addition, an inflation rate of 2 % is assumed. An emergency situation happens with a probability of 20 %. In the emergency situation, the deficit is 3 % of GDP. In years without emergency situation (normal situation), the deficit is 0.35 % of GDP. In each scenario, 10 million paths are simulated. 2 - The deficit limit of the normal situation applies every year. 3 - After an emergency situation, there is a transitional provision with a linear reduction of the deficit to the normal situation within three years. In years without emergency situation (normal situation), the deficit limit is 1 % of GDP if the debt-to-GDP ratio is below 60 % and 0.5 % of GDP if the debt-to-GDP ratio is below 90 % of GDP.

Source: own calculations

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even under these less favourable assumptions, debt ratios remain stable in the long term.

Methodological improvement of cyclical adjustment

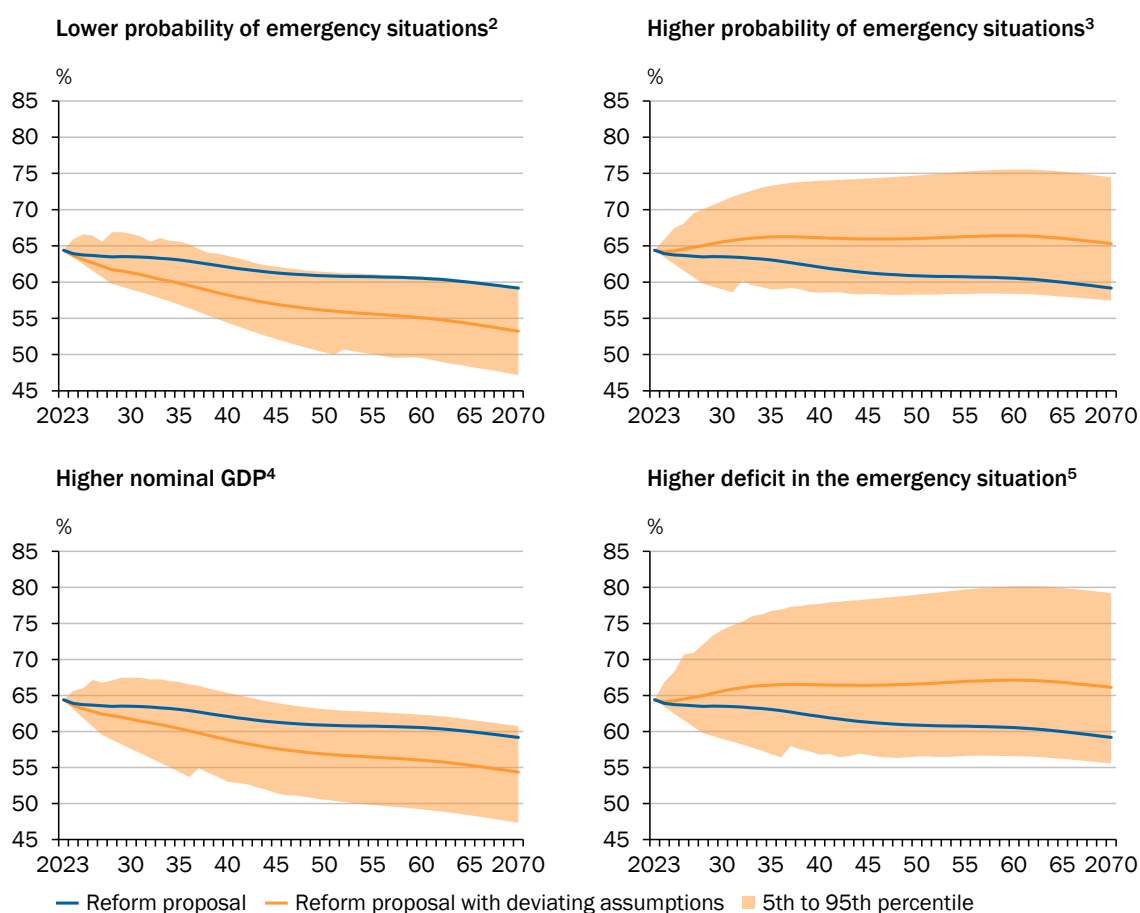
The cyclical component of the debt brake is intended to enable fiscal policy to adjust to the business cycle. By taking the cyclical situation into account symmetrically, it increases the permissible new debt in bad times and reduces it in good times (BMF, 2022; Annual Report 2019 item 439). However, the current estimation method (Havik et al., 2014) is considered susceptible to revisions and

renders cyclical budget planning difficult (Ademmer et al., 2019). The Federal Ministry for Economic Affairs and Climate Action (BMWK) has therefore organised a scientific seminar to reform the cyclical adjustment (BMWK, 2022, 2023; Boysen-Hogrefe and Hoffmann, 2023). A useful reform would reduce the susceptibility of the estimation procedure to revisions. The aim is not to expand the scope for structural deficits.

In the method currently used, the output gap is used as a measure of the economic situation as a percentage deviation of GDP from potential output. Potential output corresponds to the production

↘ CHART 3

Development of the general government debt-to-GDP ratio: Sensitivity analyses¹



1 – The simulations are based on the projections of the German Council of Economic Experts for the debt-to-GDP ratio in 2023 and the growth of real potential output until 2070 (GCEE Annual Report 2023 items 70 and 101). In addition, an inflation rate of 2 % is assumed. An emergency situation occurs with a probability of 20 %. In the emergency situation, the deficit is 3 % of GDP. In years without emergency situation (normal situation), the deficit is 0.35 % of GDP. In each scenario, 10 million paths are simulated. After an emergency situation, there is a transitional provision with a linear reduction of the deficit to the normal situation within three years. In years without emergency situation (normal situation), the deficit limit is 1 % of GDP if the debt-to-GDP ratio is below 60 % and 0.5 % of GDP if the debt-to-GDP ratio is below 90 % of GDP. 2 – An emergency situation occurs with a probability of 10 %. 3 – An emergency situation occurs with a probability of 30 %. 4 – The growth rate of nominal GDP is 0.5 percentage points higher in every year. 5 – The deficit in the emergency situation is 4 % of GDP.

Source: own calculations

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volume that would be achieved at normal capacity utilisation. However, this is an unobservable variable that must be estimated in real time and is sometimes very susceptible to revisions (Orphanides and van Norden, 2002; Ochsner and Zuber, 2022).

↘ CHART 4 LEFT Revisions to potential output can be substantial, especially after recessions (Dovern and Zuber, 2020). Only after the end of a financial year it is clear whether the actual fiscal space would have been larger or smaller (German Bundesbank, 2022). ↘ CHART 4 RIGHT

In the case of strong revisions, deficits are allowed that are either too high or too low, measured against the actual economic development, with undesirable effects on aggregate demand. Modern econometric estimation methods, such as those used by the GCEE Annual Report 2023/24, could reduce revisions to estimations of potential output and the output gap. That would be quite beneficial, but revisions can still not be completely avoided (Ochsner et al., 2024).

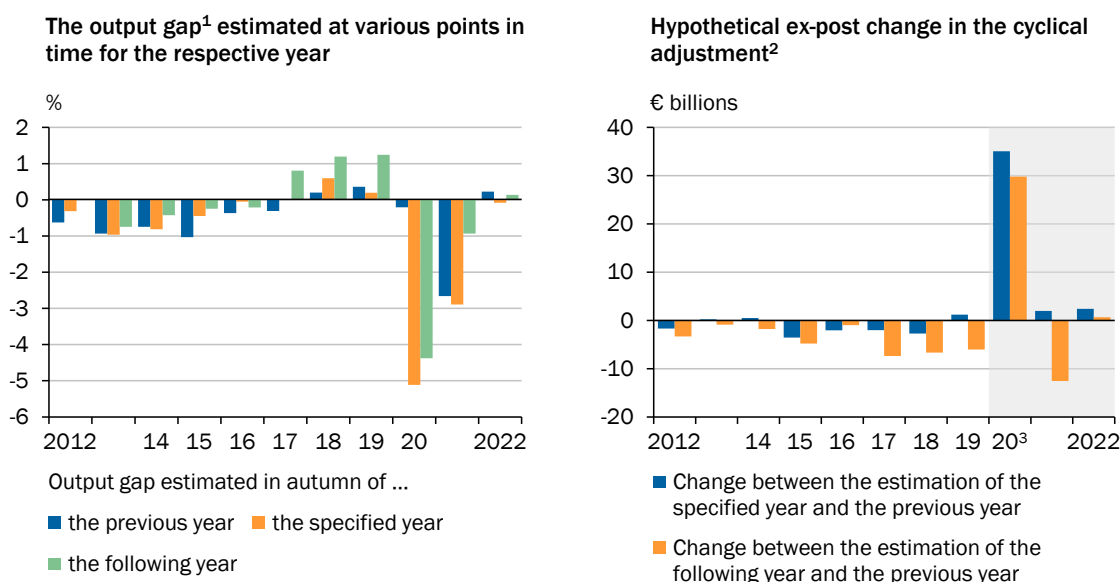
In order to reduce the impact of revisions on fiscal planning, the Deutsche Bundesbank (2022) proposes an error correction component for the

expected development of economic output and tax revenues in the coming years. This component would make it possible to take account of revisions only gradually over time and thus reduce the pressure to adjust fiscal policy, for example after a recession.

Further reform proposals relate to the control account. This is used to check compliance with the requirements for the level of new debt in budget implementation. To this end, positive and negative deviations from the deficit limit are recorded annually. If the deficit in the control account exceeds 1.5 % of GDP, the deviation must be reduced. The control limits were clearly undercut in all years up to 2019. For example, the control account had a balance of 47.7 billion euros at the end of 2022, corresponding to 1.3 % of GDP (BMF, 2023). This credit balance may not be used in future budgets. The Deutsche Bundesbank (2022) proposes offsetting balances in the control account against emergency loans.

↘ CHART 4

The output gap determines the cyclical adjustment



1 – The output gap was estimated by the European Commission using the EU procedure. 2 – The cyclical adjustment is determined when the budget is prepared (BMF, 2022; GCEE Annual Report 2019 item 439). The hypothetical ex-post change considers the difference between the cyclical adjustment when the budget was prepared in the previous year and that cyclical adjustment which would have resulted in the years after the budget was prepared based on the subsequently estimated output gap. 3 – Since the year 2020, the exception clause of the debt brake has been in effect.

Sources: European Commission, own calculations

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Conclusion

The members of the GCEE agree that the reform steps described in this policy brief represent a significant improvement on the status quo. First, a transition phase should be introduced in the years immediately following the application of the debt

brake's exception clause. Second, the regular limit for the structural deficit should be increased for low debt ratios. Third, the cyclical adjustment should be made less susceptible to revisions through methodological improvements in the estimation of potential output.

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