

MINISTRY OF HIGHER AND SECONDARY
SPECIAL EDUCATION

URGENCH STATE UNIVERSITY

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COURSE WORK

**THEME: SPECIFIC CHARACTERISTICS OF
GERMANY BUDGET POLICY**

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Urgench-2016

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Introduction

Germany, officially the Federal Republic of Germany is a federal parliamentary republic in West-Central Europe. It includes 16 constituent states and covers an area of 357,021 square kilometers (137,847 sq mi) with a largely temperate seasonal climate. Its capital and largest city is Berlin. With about 81.5 million inhabitants, Germany is the most populous member state in the European Union. After the United States, it is the second most popular migration destination in the world.

Various Germanic tribes have occupied northern Germany since classical antiquity. A region named Germania documented before 100 AD. During the Migration Period, the Germanic tribes expanded southward. Beginning in the 10th century, German territories formed a central part of the Holy Roman Empire. During the 16th century, northern German regions became the center of the Protestant Reformation.

The rise of Pan-Germanism inside the German Confederation resulted in the unification of many of the German states in 1871 into the Prussian-dominated German Empire. After World War I and the German Revolution of 1918-1919, the Empire was replaced by the parliamentary Weimar Republic. The establishment of the national socialist dictatorship in 1933 led to World War II and systematic genocide. After 1945, Germany split into two states, East Germany and West Germany. In 1990, the country was reunified.

In the 21st century, Germany is a great power and has the world's fourth-largest economy by nominal GDP, as well as the fifth largest by PPP. As a global leader in several industrial and technological sectors, it is both the world's third-largest exporter and importer of goods. Germany is a developed country with a very high standard of living sustained by a skilled and productive society. It upholds a social security and universal health care system, environmental protection and a tuition-free university education. Germany was a founding member of the European Union in 1993. It is a part of the Schengen Area and became a co-founder of the Euro zone in 1999. Germany is a member of the

United Nations, NATO, the G8, the G20, and the OECD. The national military expenditure is the 9th highest in the world. Known for its rich cultural history, Germany has been continuously the home of influential artists, philosophers, musicians, sportsmen, entrepreneurs, scientists and inventors.

Germany has a social market economy with a highly skilled labor force, a large capital stock, a low level of corruption, and a high level of innovation. It is the world's third largest exporter of goods, and has the largest national economy in Europe which is also the world's fourth largest by nominal GDP and the fifth one by PPP.

The service sector contributes approximately 71% of the total GDP (including information technology), industry 28%, and agriculture 1%.^[1] The unemployment rate published by Eurostat amounts to 4.7% in January 2015, which is the lowest rate of all 28 EU member states. With 7.1% Germany also has the lowest youth unemployment rate of all EU member states. According to the OECD Germany has one of the highest labour productivity levels in the world.



Frankfurt is a leading financial center in Europe and seat of the ECB.

Germany is part of the European single market which represents more than 508 million consumers. Several domestic commercial policies are determined by agreements among European Union (EU) members and by EU legislation. Germany introduced the common European currency, the Euro in 2002. It is a



member of the Euro zone which represents around 338 million citizens. Its **Frankfurt, the financial centre of continental Europe.**

Monetary policy is set by the European Central Bank, which is headquartered in Germany maintains a large automotive industry, and is the world's third largest exporter of goods.

Being home to the modern car, the automotive industry in Germany is regarded as one of the most competitive and innovative in the world, and is the fourth largest by production. The top 10 exports of Germany are vehicles, machineries, chemical goods, electronic products, electrical equipment, pharmaceuticals, transport equipment, basic metals, food products, and rubber and plastics.

Of the world's 500 largest stock-market-listed companies measured by revenue in 2014, the Fortune Global 500, 28 are headquartered in Germany. 30 Germany-based companies are included in the DAX, the German stock market index. Well-known international brands include Mercedes-Benz, BMW, SAP, Volkswagen, Audi, Siemens, Allianz, Adidas, Porsche, and DHL.

Germany is recognized for its large portion of specialized small and medium enterprises, known as the Mittelstand model. Around 1,000 of these companies are

global market leaders in their segment and are labelled hidden champions.[141] Berlin developed a thriving, cosmopolitan hub for startup companies and became a leading location for venture capital funded firms in the European Union.

THE LIST INCLUDES THE LARGEST GERMAN COMPANIES BY REVENUE IN 2011:

Rank	Name	Headquarters	Revenue (mil. p)	Profit (mil. p)	Employees (world)
1.	<u>Volkswagen</u>	<u>Wolfsburg</u>	159,000	15,800	502,000
2.	<u>E.ON</u>	<u>Düsseldorf</u>	113,000	1,900	79,000
3.	<u>Daimler</u>	<u>Stuttgart</u>	107,000	6,000	271,000
4.	<u>Siemens</u>	<u>Berlin, München</u>	74,000	6,300	360,000
5.	<u>BASF</u>	<u>Ludwigshafen</u>	73,000	6,600	111,000
6.	<u>BMW</u>	<u>München</u>	69,000	4,900	100,000
7.	<u>Metro</u>	<u>Düsseldorf</u>	67,000	740	288,000
8.	<u>Schwarz Gruppe</u>	<u>Neckarsulm</u>	63,000	N/A	315,000
9.	<u>Deutsche Telekom</u>	<u>Bonn</u>	59,000	670	235,000
10.	<u>Deutsche Post</u>	<u>Bonn</u>	53,000	1,300	471,000
ô	<u>Allianz</u>	<u>München</u>	104,000	2,800	141,000
ô	<u>Deutsche Bank</u>	<u>Frankfurt</u>	21,600	4,300	101,000

With its central position in Europe, Germany is a transport hub for the continent. Like its neighbours in Western Europe, Germany's road network is amongst the densest in the world. The motorway (Autobahn) network ranks as the third-largest worldwide in length and is known for its lack of a general speed limit. Germany has established a polycentric network of high-speed trains. The InterCity Express or ICE network of the Deutsche Bahn serves major German cities as well as destinations in neighboring countries with speeds up to 300 km/h (186 mph). The largest German airports are Frankfurt Airport and Munich Airport, both hubs of Lufthansa, while Air Berlin has hubs at Berlin Tegel and Düsseldorf. Other major airports include Berlin Schönefeld, Hamburg, Cologne/Bonn and Leipzig/Halle. The Port of Hamburg is one of the top twenty largest container ports in the world.

In 2008, Germany was the world's sixth-largest consumer of energy, and 60% of its primary energy was imported. In 2014, energy sources were: oil (35.0%); coal, including lignite (24.6%); natural gas (20.5%); nuclear (8.1%); hydro-electric and renewable sources (11.1%). The government and the nuclear power industry agreed to phase out all nuclear power plants by 2021. It also enforces energy conservation, green technologies, emission reduction activities, and aims to meet the country's electricity demands using 40% renewable sources by 2020. Germany is committed to the Kyoto protocol and several other treaties promoting biodiversity, low emission standards, water management, and the renewable energy commercialization. The country's household recycling rate is among the highest in the world - at around 65%. Nevertheless, the country's greenhouse gas emissions were the highest in the EU in 2010. The German energy transition (Energiewende) is the recognized move to a sustainable economy by means of energy efficiency.

Germany's achievements in the sciences have been significant, and research and development efforts form an integral part of the economy. The Nobel Prize has been awarded to 104 German laureates. In the beginning of the 20th century, German laureates had more awards than those of any other nation, especially in the sciences (physics, chemistry, and physiology or medicine).

European Space Operations Centre (ESOC) in Darmstadt



Notable German physicists before the 20th century include Hermann von Helmholtz, Joseph von Fraunhofer and Gabriel Daniel Fahrenheit, among others. Albert Einstein introduced the relativity theories for light and gravity in 1905 and 1915 respectively. Along with Max Planck, he was instrumental in the introduction of quantum mechanics, in which Werner Heisenberg and Max Born later made major contributions. Wilhelm Röntgen discovered X-rays. Otto Hahn was a pioneer in the fields of radiochemistry and discovered nuclear fission, while Ferdinand Cohn and Robert Koch were founders of microbiology. Numerous mathematicians were born in Germany, including Carl Friedrich Gauss, David Hilbert, Bernhard Riemann, Gottfried Leibniz, Karl Weierstrass, Hermann Weyl and Felix Klein.

Germany has been the home of many famous inventors and engineers, including Hans Geiger, the creator of the Geiger counter; and Konrad Zuse, who built the first fully automatic digital computer. Such German inventors, engineers and industrialists as Count Ferdinand von Zeppelin, Otto Lilienthal, Gottlieb Daimler, Rudolf Diesel, Hugo Junkers and Karl Benz helped shape modern automotive and air transportation technology. German institutions like the German Aerospace Center (DLR) are the largest contributor to ESA. Aerospace engineer Wernher von Braun developed the first space rocket at Peenemünde and later on was a prominent member of NASA and developed the Saturn V Moon rocket. Heinrich Rudolf Hertz's work in the domain of electromagnetic radiation was pivotal to the development of modern telecommunication.

Research institutions in Germany include the Max Planck Society, the Helmholtz Association and the Fraunhofer Society. The Wendelstein 7-X in Greifswald hosts a facility in the research of fusion power for instance. The Gottfried Wilhelm Leibniz Prize is granted to ten scientists and academics every year. With a maximum of €2.5 million per award it is one of highest endowed research prizes in the world.



Tourism

The Berchtesgaden alpine region. Bavaria is the overall most visited German state, and Mecklenburg-Vorpommern by domestic tourists.

Germany is the seventh most visited country in the world, with a total of 407 million overnights during 2012. This number includes 68.83 million nights by foreign visitors. In 2012, over 30.4 million international tourists arrived in Germany. Berlin has become the third most visited city destination in Europe. Additionally, more than 30% of Germans spend their holiday in their own country, with the biggest share going to Mecklenburg-Vorpommern. Domestic and international travel and tourism combined directly contribute over EUR43.2 billion to German GDP. Including indirect and induced impacts, the industry contributes 4.5% of German GDP and supports 2 million jobs (4.8% of total employment).

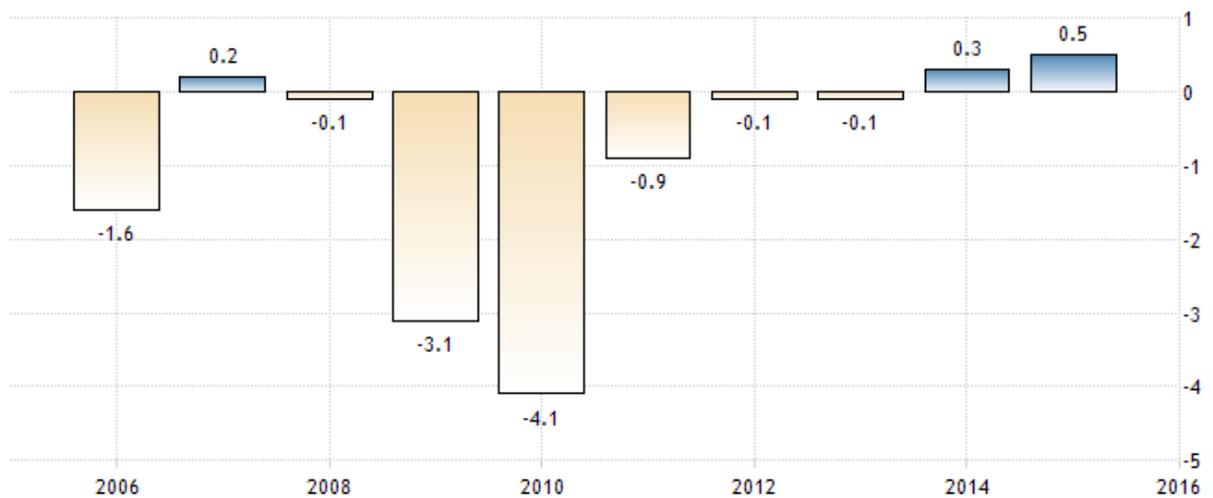
Germany is well known for its diverse tourist routes, such as the Romantic Road, the Wine Route, the Castle Road, and the Avenue Road. The German Timber-Frame Road (Deutsche Fachwerkstraße) connects towns with examples of these structures. There are 40 UNESCO World Heritage Sites in Germany, including the old town cores of Regensburg, Bamberg, Lübeck, Quedlinburg, Weimar, Stralsund and Wismar. Germany's most-visited landmarks include i. e. Neuschwanstein Castle, Cologne Cathedral, Berlin Bundestag, Hofbräuhaus Munich, Heidelberg Castle, Dresden Zwinger, Fernsehturm Berlin and Aachen Cathedral. The Europa-Park near Freiburg is Europe's second most popular theme park resort.

1. BUDGET INSTITUTIONS AND PROCESSES

Germany is expected to record a budget surplus equivalent to 0.5 percent of GDP in 2015, according to European Commission's Winter 2016 Economic Forecast. Government Budget in Germany averaged -1.75 percent of GDP from 1996 until 2015, reaching an all-time high of 1.30 percent of GDP in 2000 and a record low of -4.10 percent of GDP in 2010. Government Budget in Germany is reported by the Eurostat.

Table 1.1

GERMANY GOVERNMENT BUDGET



source: tradingeconomics.com: eurostat

1. Budgeting in Germany at the federal level is conducted on the basis of a well-developed legal, constitutional and administrative framework. The constitution or Basic Law includes foundational principles for managing public finances and the budget process, and national and federal laws provide for all of the key principles of public financial management that are traditionally found in OECD countries: annuality, universality, fungibility, parliamentary approval etc. This framework, which is respected and enforced by all participants in the budget process, ensures that there is a sound and stable basis within which the annual and multi-annual procedures are conducted.

2. Germany's debt brake rule provides a clear budget constraint which forms the backdrop to the conduct of fiscal policy. The rule, which was introduced into the Basic Law in 2009, requires that the federation and the Länder run their public finances in balance, over the course of the economic cycle, subject to limited scope for borrowing at the federal level and in response to exceptional events; and that deviations from this position be logged and corrected through a control account.

3. Since 2010, the annual budget cycle has been adapted to reflect the budget constraint, and also to allow for political steering of the resource-allocation process from the outset, resulting in a distinctive form of 'top-down budgeting'. In effect, the draft budget figures carried forward from the previous annual cycle, and which have already been designed to meet the budget constraint, form a clear starting point for setting the budget allocations in each line ministry. Budget preparations for any year y get underway in November/December of year $y-2$ (i.e. the calendar year two years before the budget year), as line ministries inform the Federal Ministry of Finance of technical updates to their baseline figures, and of the new issues or priorities that they wish to see reflected in their final budget allocations. After engagement at political level, including minister/cabinet level in the case of contentious or sensitive issues, a key figures decision is adopted by cabinet the following March (i.e. of year $y-1$) with overall allocations determined for each ministry for the budget year, and for the following three years.

4. The annual budget cycle is organised around three distinct phases or arcs: i) the preparation of the key figures decision in March, which also leads to the annual Stability Programme in April as required under EU rules; ii) the preparation of the draft federal budget and five-year Financial Plan, which are submitted to the federal parliament in August; and iii) the consideration and adoption of the budget by the parliament, with a particularly strong role for the Budget Committee of the Bundestag.

5. Budgetary and economic forecasts are informed by networks of independent and technical experts, who contribute their expertise at various stages of the process and in various fora. As well as the long-standing Council of Economic Experts which provides independent views of a range of economic themes, including budgetary forecasts, there are panels of experts tasked with preparing official economic forecasts of government, official tax revenue forecasts, and with providing an independent economic perspective to assist the work of the Stability Council, which coordinates fiscal policy across levels of government (see below). In each case, the experts' views are regarded as providing an authoritative input to the official figures, but they do not substitute for the final decision on these figures, which remains the responsibility of the political level.

6. The new top-down process promotes clarity and continuity in the medium-term dimension of budgeting. Each annual budget cycle involves the settlement of figures (at detailed line-item level) not just for the annual budget, but for the following three years. When a new annual cycle commences, the figures for that year carried over from the previous cycle provide a clear starting point or 'default position' for the budget negotiations: any new funding priorities must be accommodated either from better-than-anticipated revenues (as has, in fact, been the norm over recent years), from identifying savings or cuts within the baseline allocations, or from some combination of these approaches. Mechanisms for identifying policy savings within baseline allocations are limited.

7. Budget execution is primarily the responsibility of the line ministries, and tools are in place to allow for some flexibility in how resources are deployed. While Germany's budget includes a very high number of line items (over 6,600) in practice budget managers have latitude to move funds among cognate areas. In some areas there is also scope to carry unspent funds forward to the following budget year, although any such carry-overs must be offset by matching savings.

8. The Bundestag and its Budget Committee play a strong role in scrutinising, and in some cases amending, the draft budget prior to its

adoption. The Basic Law affords the German parliament extensive powers over the annual budget. The Budget Committee uses a system of dedicated, cross-party rapporteurs to engage directly with line ministries on the content of the draft budget. Amendments proposed by the Budget Committee are usually adopted by the Bundestag. By custom, parliamentary amendments tend to reduce, rather than increase, expenditure allocations. The parliament also has power to apply conditionality to particular budget items.

9. Germany's budget documentation includes much detail about financial allocations and purposes, but does not include specific information correlating budget programmes with strategic objectives or performance indicators. Previous reform initiatives aimed at providing a performance framework for the budget, and strengthening its cost-accounting basis, did not find favour with the Bundestag. Ongoing reforms are geared towards supplementing the traditional budget with narrative information about the broader strategic context of expenditure programmes.

10. In addition to traditional audit functions, the Federal Court of Audit contributes to the budget process at a number of stages. The Court is involved in discussions between the Federal Ministry of Finance and the line ministries on the latter's detailed budget bids (i.e. after the key figures decision in March) so that relevant audit findings can be taken into consideration. The Court may also be called upon to provide information during the parliamentary stages of budget deliberation.

11. Long-term sustainability is monitored through a periodic report prepared by the Federal Ministry of Finance. The report provides clear projections and scenarios for how the public finances may develop over a 50-year horizon, and highlights the role of key assumptions (demographic, migration,

labour-market participation and other factors). The report does not feed directly into the policy deliberation processes associated with the budget. There are different mechanisms for reporting on fiscal risks ó depending on the type of

risk ó in addition to the qualitative discussion that appears in the EU-related Stability Programme document in April.

12. Capital budgeting in Germany emphasises the principle of value-for-money, in particular with regard to how Public-Private Partnerships are handled. Germany uses an iterative approach, whereby capital investment projects are subject to increasing levels of scrutiny of their overall societal

cost/benefit and various financing options. With the active participation of parliament, political preferences are brought to bear upon project selection.

13. A "Stability Council" handles the coordination of fiscal policy among the entities of government at federal and sub-national level. Germany's Basic Law provides for the autonomy of the federation and the Länder on budgetary matters, for the sharing of national revenues and for the coordination of budgetary policy to ensure compliance with EU economic governance rules. The Stability

Council brings together the ministers of finance from federal and Länder levels, along with the federal minister of economics, to discuss budgetary matters and conduct mutual budgetary surveillance. As a forum for peer discussion, the Council has no formal enforcement powers. The full rigours of the debt

brake rule do not apply to the Länder until 2020; they are in a transitional phase at present whereby a number of Länder, with unbalanced fiscal positions, must commit to a multi-annual consolidation path in exchange for federal budgetary assistance.

14. Overall, Germany's top-down budget framework provides a solid basis for determining financial allocations and maintaining their continuity through the medium-term, consistent with the requirements of the budget constraint. Ongoing and future reforms should aim at counter-balancing the strong bureaucratic momentum of the multi-annual allocations with enhanced opportunities for review, reevaluation and re-prioritisation of the baseline allocations. Periodic spending reviews, as practiced in several OECD countries, could play a useful role in this regard, and indeed a commitment to this type of

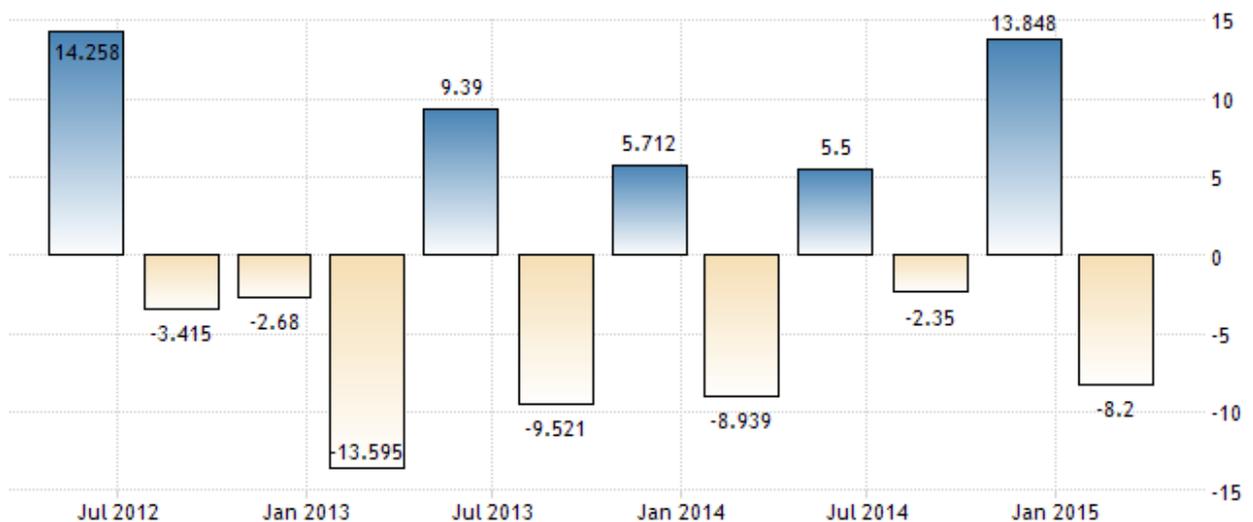
reform has been included in the Coalition Agreement of the current government. Renewed attention to the performance aspects of budget allocations, in particular as they relate to government strategic objectives, would progress the budget accountability process beyond its current focus on detailed financial allocations. A Citizen's Budget showing the "big picture" of what the budget is intended to accomplish would enhance transparency for citizens, and may also foster a stronger engagement among all stakeholders – including in parliament – upon the outcomes and impacts of budgeting.

2. PRINCIPLES OF BUDGETING IN GERMANY

Germany recorded a government budget deficit of 8.20 EUR Billion in the first quarter of 2015. Government Budget Value in Germany averaged -10.14 EUR Billion from 1991 until 2015, reaching an all time high of 40.63 EUR Billion in the third quarter of 2000 and a record low of -42.54 EUR Billion in the first quarter of 2004. Government Budget Value in Germany is reported by the Deutsche Bundesbank.

Table 2.1

GERMANY GENERAL GOVERNMENT BUDGET VALUE



source: tradingeconomics.com: eurostat

The constitutional and legal framework of Germany pays particular attention to a specification of the rules and principles under which budgeting is to be regulated and conducted. The key principles that can be abstracted from this framework are as follows:

-Universality: each government entity is required to have a budget that deals comprehensively and authoritatively with all expenditures and revenues, subject only to very limited exceptions.

-Specificity: Every budget chapter must be linked to a stated purpose, which prescribes and limits the uses to which the funds may be applied. Budget notes may specify items further.

-Fungibility: All revenues raised are used to cover all expenditures via a single federal account. Ear-marking of funds is thus disallowed (other than for pensions and health insurance).

-Formal annuality: the budget must deal with a one-year period or (in principle) a two-year period where each year is treated separately. In practice, the latter provision has not been applied to the federation.

-Practical multi-annuality: the budget must be accompanied with a five-year Financial Plan showing (on a basis that is not formally binding) the evolution of the public finances.

-Timeliness: the annual budget must be enacted before the start of the financial year.

-Financial sufficiency and necessity: Funds should be budgeted in sufficient amount but no more to cover statutory purposes and other requirements of the budget period.

-Packaging prohibition: The budget act may not deal with matters unrelated to the annual budget.

-Efficiency and economy: Funds must be allocated and used having regard to these complementary principles, which deal respectively with the achievement of optimal results with allocated resources, and the reduction in resource utilisation in achieving results.

-Budgetary balance: the recent debt brake rule re-casts and strengthens the former budgetary principle about maintaining a broad balance between expenditure and revenues. From this fundamental constitutional imperative, ancillary principles regarding the accuracy and reliability of the budget data, which are the key tools of fiscal management, might reasonably be inferred.

-Democratic authorisation and accountability: The parliament (in particular the Bundestag or lower house) has full power to authorise and amend the budget, and to receive audited accounts of its implementation.

The Gross Domestic Product (GDP) in Germany was worth 3868.29 billion US dollars in 2014. The GDP value of Germany represents 6.24 percent of the world economy. GDP in Germany averaged 1834.61 USD Billion from 1970 until 2014, reaching an all time high of 3868.29 USD Billion in 2014 and a record low of 215.02 USD Billion in 1970. GDP in Germany is reported by the World Bank Group.

Table 2.2

DYNAMICS OF GDP OF GERMANY (BILLION DOLLARS)

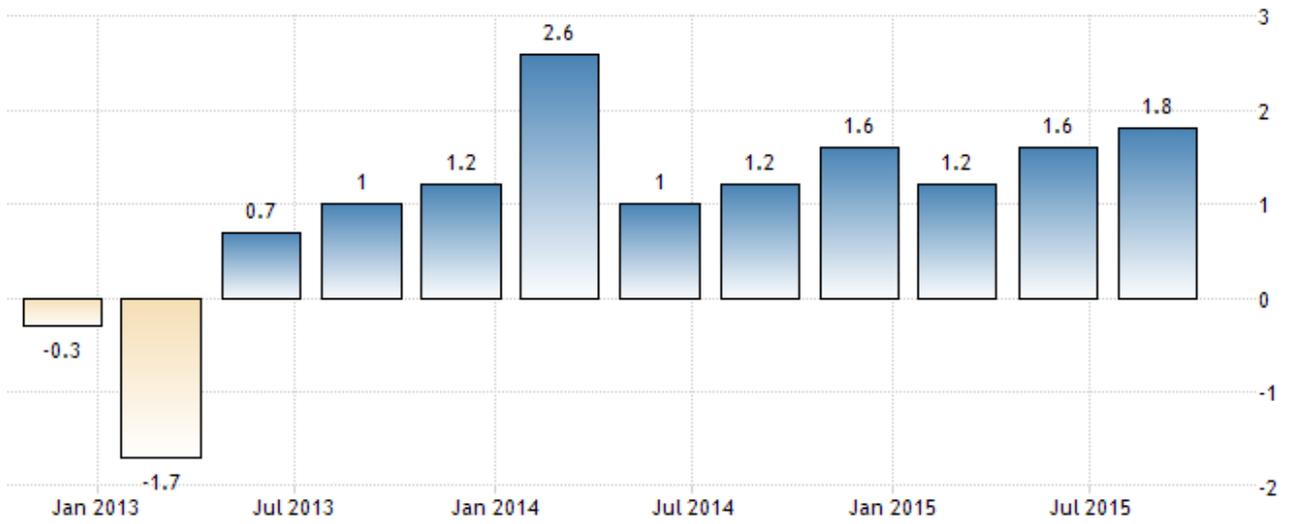


source: tradingeconomics.com: eurostat

The German economy advanced 1.7 percent in 2015, better than a 1.6 percent expansion in 2014 and higher than market expectations of 1.6 percent. It is the best performance in four years, boosted by domestic demand. Private spending increased the most since 2000 while foreign trade contributed only marginally to growth. GDP Annual Growth Rate in Germany averaged 1.33 percent from 1992 until 2015, reaching an all time high of 6 percent in the first quarter of 2011 and a record low of -7.90 percent in the second quarter of 2009. GDP Annual Growth Rate in Germany is reported by the Federal Statistical Office.

Table 2.3

GERMANY GDP ANNUAL GROWTH RATE



source: tradingeconomics.com: eurostat

3. TOP-DOWN ASPECTS OF BUDGETING

In Germany, the budget operates as the primary instrument of fiscal policy, as laid down in the debt brake rule and the more recent EU economic governance framework. The fiscal policy parameters derived from the debt brake are established in the early part of the budget-making process, and are reflected in particular in the internal budget estimate (for general government) that is formulated in February/March.

These parameters are acknowledged by all budget participants as having primacy, in that all other aspects of policy-making – in particular the expenditure allocations – must be subordinated to the need to respect the fiscal constraint, and must be adjusted accordingly to this end. This approach to budget formation is an example of ‘top down budgeting’, as distinct from the ‘bottom up’ approach whereby the resource demands from line ministries and agencies are a key determinant of the final macro-fiscal outcome.

In Germany’s case, however, the early formulation of budgetary aggregates dovetails with the ‘political’ phase of budget-making, whereby all ministries and the Federal Chancellery signal their new funding priorities and strategic orientations for the budget year. Resolving the policy and funding issues that arise is handled in the first instance by the Federal Ministry of Finance, but contentious issues are discussed and settled at the political level, including at cabinet as necessary. As outlined in the previous section, the culmination of this process is the ‘key figures decision’ whereby the government agrees overall allocations for each line ministry. Top-down budgeting was introduced as a political fiat of the German government of 2010-2013, reflecting the high political priority of aligning the annual budget process with the requirements of the debt brake rule, while also allowing space for political priorities to be brought to bear upon resource allocations. As such, top-down budgeting does not currently feature as part of the formal Federal Budget Code.

A key advantage of top-down budgeting is the greater certainty that it brings to the course of fiscal policy, especially when allied with a strong medium-term

dimension to resource allocation, and the associated benefits of greater domestic and international confidence in the sustainability of the public finances. This greater certainty should also facilitate stronger medium-term planning, serious consideration of structural reforms (which sometimes yield their full benefits and savings beyond the initial budget year) and prioritisation among ministries, as well as a heightened awareness of the trade-offs that must be contemplated in pursuit of broader strategic policy objectives of government.

Top-down budgeting in practice

The effectiveness of Germany's budget process in maintaining expenditure policy within pre-set limits can be understood through considering the practical elements of the budget-formation process. In the December of the year before budget process gets under way in earnest (i.e. the autumn of year y-2, where the budget relates to year y) the Federal Ministry of Finance commences the process of gathering the various inputs – technical, forecasting-related and political – that require an updating of the figures laid down in the previous year's cycle. In this context, the Federal Ministry of Finance enters into a process of technical discussions with line ministries about the expenditure projections, using the figures from the previous cycle's Financial Plan as a clear starting point. These discussions focus upon technical factors – e.g. demographics, economic projections, changed assessments of demand for certain programmes – that may affect the accuracy of the previous projections. While line ministries supply as much technical detail as possible to support their claims for adjusted figures, it should be noted that this phase of the process is not a 'negotiation' (unlike the situation that obtained in the earlier era of 'bottom-up budgeting'): no budget figures are formally agreed with ministries at this point. Any such agreement is reserved until policy / political priorities have also been taken into account and ultimately decided upon by government in its key figures decision.

It should also be noted, however, that a large proportion of overall expenditure -approximately 90%- is statutorily- based, and accordingly there is a certain degree of momentum and continuity from one year's figures to the next.

The official-level discussions are facilitated through the financial management IT system which underpins the budget process across government. The budget projections -for every chapter and line item- are contained within the IT system. While this round of technical consultations is carried forward, the mirror units in the Federal Ministry of Finance start parallel meetings with the budget director and the directorate-general's steering unit for the planning process.

In these discussions, the information gleaned from the technical consultations is weighed together with various high-level and strategic priorities, and on this basis the Federal Ministry of Finance prepares its proposal for the key figures, i.e. the aggregate budget allocations for each ministry. This politically-sensitive phase of the budget process involves close contact with the political levels of the Ministry, and ongoing liaison with the Federal Chancellery. The aforementioned discussion and settlement at the political level is primarily performed by sending out the proposal of the Ministry of Finance (MOF) for the benchmark figure decision at the state secretary level to the line ministries and -if needed- negotiating it at this political level before it is brought to cabinet.

The benchmark figures are decided by government in a cabinet session in March. The figures show the total revenue and expenditure for each line ministry for the upcoming budget year and the medium term planning period. Any changes from the figures set out in the previous year's budget cycle are explained in an aggregate manner, e.g. naming the new initiative for which new resources are allocated. The key figures decision is regarded as binding at the level of ministry allocation. After the key figures decision has been made, the next phase of the top-down process is concerned with filling in the line-item detail of the highly aggregated figures.

This is the only phase of the budget process where negotiations take place on operational level, and they should be settled in a bottom-up manner below the political level (except in the case of particularly contentious items that may require State Secretary-level intervention). This detailed draft budget is decided by the government at the end of June / beginning of July and then submitted to the

parliament. An obvious potential limitation with this approach is that, in circumstances where demographic and other technical drivers call for extra spending, above and beyond what would be permitted under the debt brake, there is little guidance as to how the Federal Ministry of Finance should adjudicate among the claims of different line ministries, or re-prioritize overall spending to stay within permitted limits. Indeed, the early official-led process appears quite bottom-up and technical, focusing as it does upon the variations that may be called for within each of the line items in the budget and this might seem difficult to reconcile with the requirements of a top-down, fiscally constrained approach. In recent years, these aspects do not appear to have presented a significant hindrance for Germany's budget process.

One reason for this is that the budgetary forecasts supplied at each phase or arc of the process have usually been over-pessimistic; and the budget actors have come to expect that additional resources can be found to meet new pressures as the process moves forward, rather than have to engage in more difficult rounds of re-prioritization. In fact the budget process has an intrinsic incentive to this effect:

improvements in economic forecasts in January and in April provide extra funds to accommodate the budget-formation process; if however the forecasts come in below expectations, it is the Federal Ministry of Finance that is expected to bear the cost of correction.

Notwithstanding these incentives, in the process of preparations for the 2014 budget, with the expiry of certain transitional aspects of the fiscal rule framework, it became apparent at an early stage (January 2013) that an additional significant quantum of savings would be required. Securing agreement on these savings called for a new ad hoc budget flexibility mechanism, which discussed below.

The German economy grew a seasonally-adjusted 0.3 percent in the third quarter of 2015, slowing from a 0.4 percent expansion in the June quarter and matching preliminary estimates. A faster increase in household and government spending were unable to offset a further decline in investment and a downward effect of foreign trade. GDP Growth Rate in Germany averaged 0.31 percent from

1991 until 2015, reaching an all time high of 2 percent in the second quarter of 2010 and a record low of -4.50 percent in the first quarter of 2009. GDP Growth Rate in Germany is reported by the Federal Statistical Office.

4. BUDGET EXECUTION AND MONITORING

Once the allocations for each ministry are laid down in the budget act, the Federal Ministry of Finance issues administrative regulations as provided for under the Federal Budget. These regulations, known as the budget management circular, provide further details regarding how certain aspects of the budget act

are to be implemented in a uniform manner across federal ministries and agencies. Subject to these legal and administrative requirements, budget implementation is primarily the responsibility, and indeed the prerogative, of the ministries themselves – the Federal Ministry of Finance does not see itself as a partner, supervisor or authoriser of the disbursement and use of funds in the

implementation phase, other than in exceptional circumstances. The mirror units within the Federal Ministry of Finance – the units which oversee spending within the various line ministries – place a heavy reliance on engagement with their counterparts during the process of budget preparation and formulation: it is during this phase that the Federal Ministry of Finance has an opportunity to input its analysis into the policy formulation debate (for example, in the area of active labour market policies which have been a live policy issue over recent years). Thereafter, the ministries themselves have a large degree of autonomy. In keeping with the top-down budgeting approach, the devolution of responsibility to the line ministries is accompanied with a strong role for budget planners within these organizations.

There are approximately 9 000 budget managers who are responsible for some elements of the overall federal budget of approximately EUR 300 billion each year; within each line ministry, there is a designated budget officer who heads the ministry's budget office, and whose role it is to ensure that funds are assigned to the proper areas and that budget limits are respected. The budget officer is accountable directly to the minister and to the administrative head of the ministry in the exercise of this task. The full budget allocation is available to each ministry from the federal treasury on 1 January each year.

Ministries in turn release funds to their subsidiary agencies as and when required (usually in monthly tranches). The ministries provide a monthly cash expenditure profile or outflow estimate to the Federal Ministry of Finance to assist in overall liquidity management. The treasury IT system allows the drawdowns of expenditure to be monitored in real time by the Federal Ministry of Finance – both the treasury division and the mirror sections – which oversee the expenditure of the line ministries – so that any deviations from the profile can be identified month-to-month.

If, towards the final months of the year, a line ministry finds that spending pressures have arisen (e.g. demographic or labour-market movements affecting the outlays of the Ministry of Labour Affairs, which has a very large budget allocation), the ministry is expected first to attempt to meet the pressures from existing resources through reallocation; and only as a last resort is it expected to approach the Federal Ministry of Finance for extra funds. Mirror units have the ability to monitor expenditure line-by-line – i.e. by reference to each of the 6 600 line items in the budget – but they do not generally intervene in budget execution.

In exceptional cases, where it has concerns about budget expenditure or execution, the Federal Ministry of Finance has the power to block or hold particular areas of expenditure by a line ministry until these concerns are addressed. In addition, parliament when approving the budget has the power to apply a qualified freeze on expenditure: this is tantamount to an approval in principle, subject to close oversight and additional detail at the implementation phase as to how the funds will be allocated. It is the Federal Ministry of Finance that decides if conditions are met for such freezes to be lifted; although in exceptional cases the prior consent of the Bundestag itself may be required (as per section 22 of the Federal Budget Code). Special provisions apply for capital expenditure, which as a rule must be accompanied by detailed plans regarding outlays, investment and project completion. In the absence of these plans, the Federal Ministry of Finance has more extensive powers to intervene and to place a hold on expenditure.

Flexibility within the budget implementation phase

Budget allocations are annual, not multi-annual, and managers expected to use their allocated resources within the year towards the stated purposes. Moreover, there is a strong expectation that funds allocated will not be exceeded, and in practice the number of supplemental appropriations is limited.

Authorization of such supplemental appropriations by the Federal Ministry of Finance is not a routine matter: the additional funds may be authorized only if there is an unforeseen and compelling need and in cases specified by law after first informing the Budget Committee of the Bundestag. However, the German system includes some additional flexibility for funds to be re-allocated within the year (virement) and for funds to be carried over from one year to the next, subject to restrictions as explained below. Virement: Although Germany's budget system uses a large number of individual line items, budget managers within departments may transfer funds within administrative groupings of expenditure as designated in the budget document.

These groupings relate to personnel expenditure, non-personnel administrative expenditure, and various categories of capital expenditure (viz. construction works, large scale investment, and other capital expenditure). In practice, there is virtually unlimited scope for such virement within the same grouping, and there is a 20% leeway for virement across groupings (provided all are within the same chapter of the departmental budget). Such virements, which are provided for under section 20 of the Federal Budget Code, do not as a rule require advance approval of the Federal Ministry of Finance, although unforeseen virements beyond these limitations and across different chapters are subject to advance approval. In practice, therefore, the large number of budgetary line items is a legacy of the bottom-up tradition of budgeting is counter-balanced with flexibility mechanisms.

The high level of detail represents a significant bureaucratic overhead compared with the approach taken in several other OECD countries, where a radical consolidation and streamlining of line items over the years has significantly

reduced the need for virement, allowing managers to pay more attention to non-financial information on performance and results. While the additional financial detail is not without its compensating benefits – for example in terms of maintaining a close oversight of budget execution – there is a case for re-considering the balance and type of data being used in Germany's case, as the top-down budgeting approach becomes embedded in it. Carry-over: Section 19 of the Federal Budget Code allows for appropriated funds from one year to be carried over for use for the same purpose in the following year, subject to conditions.

The main condition is that the carryover must be justified in each case by an objective requirement to do so (e.g. a legal or contractual obligation): in practice this means that the carryover facility is not a tool routinely or arbitrarily available for budget managers. Investment expenditures (and expenditure from earmarked revenues) are automatically eligible for such carry-over; other types of expenditure may be declared eligible – if this promotes their efficient and economic use. In practice, the latter procedure is occasionally followed for current programme expenditure, although there is some flexibility allowed with respect to administrative expenditure.

A distinctive feature of Germany's approach to carry-over is that any such expenditure in the second year must be explicitly financed through savings in other areas of the departmental budget. This approach ensures that carry-over does not entail any adverse impact on budgetary plans and the public finances, and it requires departmental budget managers to prioritize within their overall allocations and to pay special attention to timely budget execution. On the other hand, the incentives for managers to realize savings and efficiencies in budget execution would appear limited under this model compared to the experience of

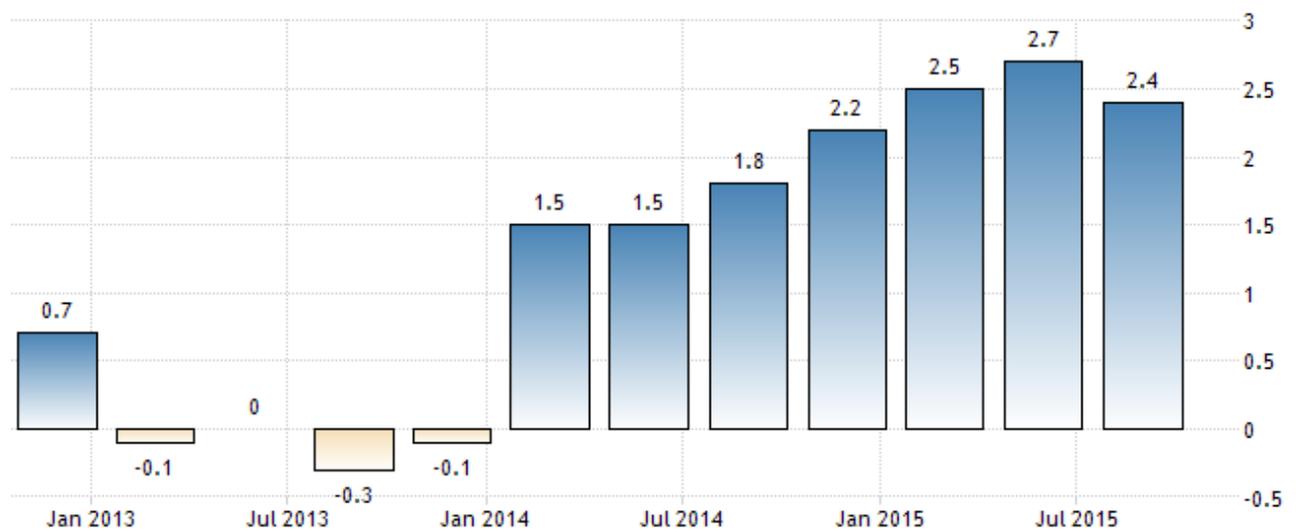
other OECD countries which allow departments to retain the benefits of year-end savings for carry-over purposes, without the requirement to recover the use of such funds through offsetting revenue or savings measures.

German real wages rose by 2.5 percent in 2015 following a 1.7 percent growth in 2014 and hitting its steepest increase since the index began eight years

ago, according to preliminary data from the statistical office. The increase was led by a record-low inflation of 0.3 percent along with robust pay hikes of 2.8 percent, as wages in eastern Germany went up by 3.9 percent while those of western Germany rose by a slower 2.5 percent. Although German economy is generally fueled by exports, domestic demand has recently taken over as the main driver of growth. Wage Growth in Germany averaged 0.70 percent from 2007 until 2015, reaching an all-time high of 2.70 percent in the second quarter of 2015 and a record low of -1.40 percent in the fourth quarter of 2007. Wage Growth in Germany is reported by the Statistisches Bundesamt.

Table 4.1

GERMANY REAL WAGE GROWTH



source: tradingeconomics.com: eurostat

Overview of national fiscal policy

The major budget reforms of 1967-1971 included a strong macroeconomic dimension, recognizing the role of annual budget policy in promoting broader aims of fiscal and economic management. In this context, the budget-related articles of the Basic Law were revised, enshrining the ‘golden rule’ tradition (see Box 2.2 below) and providing for the principle of ‘overall budgetary equilibrium’, consistent with price stability, high employment and economic growth, through balanced fiscal policy over the economic cycle; and a number of federal laws were

enacted in support of these objectives. In particular, the Act to Promote Stability & Growth of 1967 provided that surplus revenues arising during periods of above-trend growth (in the case of an extension in demand exceeding economic capacity) should go towards paying off national debt, or towards accumulation of a counter-cyclical reserve fund. This reserve fund was to be maintained by the Deutsche Bundesbank and could be drawn down only for the purposes of stimulating demand (through additional expenditure and investment activity)

during an economic downturn. While the counter-cyclical reserve fund fell into disuse shortly after its introduction, similar principles of symmetrical counter-cyclical budgetary management are embodied in Germany's recent fiscal reforms,

which are discussed below. In addition, the 1967 Act provided for the five-year Financial Plan that is still a central part of the budgetary planning framework. Over recent decades, the national and international climate for fiscal policy-making has changed significantly, including through the introduction of Economic and Monetary Union in the EU, and the associated introduction of the Stability & Growth Pact (SGP). As a euro-area country, Germany is bound by the provisions of the SGP and by the more fully-elaborated economic governance requirements set out in 2011-2013. At the heart of these rules is a requirement to maintain the public finances at a balanced position (in underlying, cyclically adjusted terms), and to correct any deviations from this position. However, the starting-point for Germany in establishing its fiscal policy stance each year is not the new EU governance rules per se, but rather the 'debt brake' rule which was incorporated into its Basic Law in 2009 (see Box 2.2). The rule was the center piece of a package of fiscal-responsibility reforms introduced at the time, including federal assistance for progressive budget consolidation in the Länder. In essence, the debt brake requires that budgets (for Länder and the federation alike) be balanced, in structural terms. For the federation, 'balance' entails latitude for borrowing to an upper limit of 0.35% of GDP; the Länder have no such latitude.

Government Debt in Germany is expected to decline to 71.6 percent of GDP in 2015 from 74.9 percent in 2014, according to European Commission's Winter

2016 Economic Forecast. Government Debt to GDP in Germany averaged 66.73 percent from 1995 until 2014, reaching an all-time high of 80.30 percent in 2010 and a record low of 55.60 percent in 1995. Government Debt to GDP in Germany is reported by the Eurostat.

Table 4.2

GERMANY GOVERNMENT DEBT TO GDP



source: tradingeconomics.com: eurostat

Germany's Debt Brake

Prior to 2009, Germany's fiscal policy course was influenced by a long-standing constitutional requirement that revenue obtained by borrowing shall not exceed the total of investment expenditures provided for in the budget subject to exceptions to prevent a disturbance of the overall economic equilibrium. The rationale for such a "golden rule" was that capital investment should promote economic capacity and thereby increase the serviceability of debt.

Over the decades, however, the rule proved ineffective at slowing the build-up of debt or of dampening pro-cyclical fiscal policy (OECD, 2008 ó Economic Survey of Germany).

In 2009, on the basis of groundwork by the Federal Ministry of Finance and a proposal by the Federal Commission (Föderalismuskommission), the proposal to replace the golden rule with a debt brake was approved by the German parliament and enshrined in the constitution. The avowed objectives were to improve the

sustainability of the national finances, with strengthened fiscal coordination among federal and Länder levels, while providing flexibility to deal with cyclical and demographic challenges. The core elements of the debt brake are as follows:-

- **Balanced budgets:** Both the federal and Länder governments must balance revenues with expenditures in their budgets, as a fundamental principle. In normal economic circumstances (i.e. when the output gap is closed), *öbalanceö* is assumed to be met for the federal government when net borrowing does not exceed 0.35% of GDP. (This is approximately a threefold reduction in the latitude for borrowing, as compared with the former golden rule.) There is no such latitude in normal times for the Länder.

É **Symmetrical adjustments over the economic cycle: Automatic stabilizers will operate freely and fully over the cycle.** In other words, cyclical deficits may be run in a downturn, and cyclical surpluses must be run in an upturn. The technical determination of the stage in the economic cycle is handled in line with EU methodologies, and is dealt with (for federal purposes) under an Act and a technical ordinance. The Länder make their own implementation arrangements.

É **Underlying, not artificial, budget position:** *öFinancial transactionsö* within government, such as the sale of an asset yielding one-off revenues, must be netted off from the figures so that the true underlying budget position is used.

É **Control and Correction:** Deviations, either positive or negative, from the permissible borrowing amount that arise during budget implementation are not simply forgotten about: they are booked to a standing *öcontrol accountö* which must be balanced over time. (Deviations arising from unanticipated cyclical changes are not so booked: it is assumed instead that these issues would be covered through re-calculated automatic stabilizers.) Redemption of the control account is required once it reaches 1% of GDP; however, to limit procyclical effects, redemption may be deferred during a downturn, and is in any event capped at 0.35% of GDP even during an upturn.

É **Limited exceptions:** Additional borrowing is allowed to deal with natural disasters and exceptional emergencies beyond state control, and with severe

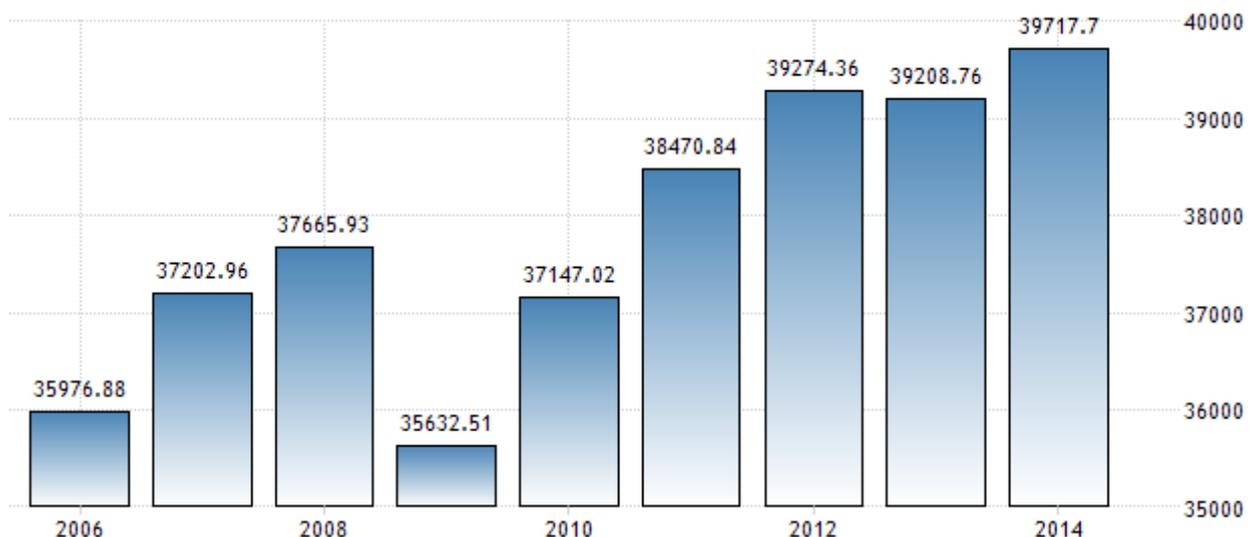
consequences for the public finances. A majority of Bundestag members must ratify any such decision, along with an amortization plan to repay the borrowings within an appropriate time period.

É Transitional arrangements: Since the debt brake became effective in 2011, in the midst of the global financial crisis, additional borrowing latitude is allowed, but this must be phased out (i.e. the 0.35% limit for the federal government becomes fully effective) from 2016. For the Länder, the ban on structural borrowing will be fully effective from 2020 onwards.

The Gross Domestic Product per capita in Germany was last recorded at 39717.70 US dollars in 2014. The GDP per Capita in Germany is equivalent to 314 percent of the world's average. GDP per capita in Germany averaged 28937.39 USD from 1970 until 2014, reaching an all-time high of 39717.70 USD in 2014 and a record low of 17463.91 USD in 1970. GDP per capita in Germany is reported by the World Bank.

Table 4.3

GERMANY GDP PER CAPITA



source: tradingeconomics.com: world bank

5. FISCAL POLICY AND COORDINATION: SUMMARY ASSESSMENT

The necessity for coordination of fiscal policy across the levels of government has been recognized within Germany's constitutional and legal framework over the decades. The budgetary innovations over the past number of years aim to strengthen this tradition by putting in place clear and binding fiscal constraints coupled with national coordination and surveillance mechanisms.

For the new arrangements, centered upon compliance with the debt brake rule, to work effectively in support of sustainable fiscal policy, a number of conditions will need to be satisfied:

The economic forecasts, including the position in the economic cycle, will need to be accurate and reliable – in particular they should be systematically neither over-optimistic nor over-pessimistic. As matters stand, faulty economic forecasts in either direction have no direct repercussions for budgetary policy (the expectation being that revised cyclical calculations will feed into the policy stance into the future). In principle a sequence of over-optimistic forecasts could allow the public finances to drift badly off course before correction mechanisms set in.

Conversely, a reputation for over-pessimistic forecasts, with additional revenues being identified during the budgetary formulation cycle to help overcome contentious resource-allocation issues, could in time undermine the credibility of expenditure limits and weaken the political and administrative resolve to priorities within fixed allocations. Furthermore, the consistent build-up of reserves in the –control account, for reasons more related to economic forecasting than to budgetary execution, could undermine the effectiveness of this mechanism for signaling issues in budgetary execution. If these risks were to materialize, the debt brake itself would over time become no guarantee of compliance with the EU economic governance rules.

Addressing these issues is primarily a matter for the quality and integrity of the budgetary forecasts, which is discussed in Section 4 in particular.

É The modalities for implementing and enforcing the debt brake rules will need to be equally

effective in each governmental domain. In effect, once the various transitional phases are completed between now and 2020, there will be not one but 17 debt brakes in operation in Germany, i.e. one for the federal government and one for each of the Länder, as mandated under Article 109 of the Basic Law. A careless approach to implementation in a small number of government entities could have repercussions for the national public finances.

É The record of disciplined budgetary execution needs to be maintained across all ministries at the federal level, as well as improved upon in the case of several of the Länder. As regards the federal ministries: at present, the debt brake is silent on the question of how to deal with ministries that persistently overspend; indeed, if a line ministry were to become reckless about overspending, the consequences (assuming the control account to be effective) would be borne across government as a whole rather than directly by the offending line ministry. The question of managing incentive effects such as these for spending ministries is something that is typically dealt with by other OECD countries within their medium-term expenditure framework, something that is not currently accommodated within the administrative procedures for preparing

Germany's Financial Plan.

Performance-related budgetary reform efforts up to 2010.

As background for more recent developments, it should be noted that the Federal Ministry of Finance has been devoting attention to the issues involved in cost-effective management of budgetary resources over many years. In particular:

É Standardized cost accounting was introduced in 1997 for selected state agencies and rolled out progressively to other bodies.

É Flexible budget management was introduced in 1998 so that administrative resources could be transferred more easily towards areas of greater need

É The concept of product budgeting was first applied in 2000, with pilot testing in a number of areas. Product budgeting represents a programmatic approach to budgeting combined with a strong cost accounting dimension so that the cost-effectiveness of different areas can be compared.

É In 2003, a Chart of Administrative Accounts was first drafted, providing a standardized basis for cost accounting in different areas, whether in the federal or Länder levels.

É In 2006, the MHR budget modernization initiative (Modernisierung des Haushalts und Rechnungswesens, Modernizing of the Budgeting and Accounting system) was launched with the establishment of a project group to build upon the experiences of the previous years, and lay the basis for a comprehensive model of product budgeting including output-based performance reporting.

É In 2010, the MHR initiative stalled due to lack of parliamentary support (see below). The MHR project group took cognizance of performance-related budgeting reforms in other countries, and engaged in discussions with stakeholders including the Budget Committee of the Bundestag, the individual line ministries and the Federal Court of Audit. The proposed reform model covered a number of topics. These included elements that would change the budget in the direction of a programme-based budget with quite detailed output measures:

É The structurally-based budgetary chapters would be replaced with one or more products (i.e. functional programmes), with a maximum of 1 000 products for the whole of the federal government. The budgets for every product would be binding.

É For each product, non-financial output measures would be specified.

É Within each product, there would be highly aggregated line items. These line items would be binding but there would be broad flexibility for transfers between some or all of them.

É The budget and accounting of these binding figures would remain cash based, but there would be a parallel non-binding accrual-based accounting system for ex post reporting purposes, with standardized core elements. The federal

government as a whole was to produce an enhanced list of assets and of liabilities, although it would not produce a comprehensive balance sheet. However, without parliamentary support, the federal reform was abandoned in July 2010. Among the Parliament's main objections were the changed focus of allocating funds to output categories and the reduction of the number of individual appropriations. Taken together, the anxiety was expressed that this change would result in a reduction of parliament's control over the budget and the government's finances.

The issue of moving towards more commercial accounting systems at a time when the world was experiencing a global financial crisis may also have played a role in the parliament's scepticism. The parliament consequently blocked the budgeted funds for the reform.

Imports in Germany decreased to 81700 EUR Million in November from 83800 EUR Million in October of 2015. Imports in Germany averaged 23550.85 EUR Million from 1950 until 2015, reaching an all time high of 84514.70 EUR Million in March of 2015 and a record low of 346.78 EUR Million in May of 1950. Imports in Germany is reported by the Federal Statistical Office.

Table 5.1

GERMANY IMPORT (MILLION USD)



source: tradingeconomics.com: Federal statistical office

Types of Performance Budgeting

Presentational performance budgeting requires the publishing of performance information in budgets and other government documents (e.g. annual reports). The information can refer to targets, the results against them or both. While it serves to disseminate information for greater transparency and accountability of government operations, it is not intended to play an explicit role in decision making.

Performance-informed budgeting takes presentational performance budgeting a step further and requires that either proposed future or past performance are used to inform the process of allocation of resources during the budget formulation. Performance information is used along with other information in the decision-making process. This approach, in various forms, is currently the most commonly used form of performance budgeting in OECD countries.

Direct (or formula) performance budgeting requires the allocation of resources with explicit reference to proposed, future or past performance. In practice, this form of performance budgeting is used only in specific sectors, such as education and health. For example, the number of students who graduate with a Master's degree, either in the current year, in the past or a combination of the two, will determine the following year's funding for the university running the programme.

6. ISSUES IN BUDGET ACCOUNTING

The question of which system of accounting to use in presenting budget information is of fundamental importance, and has been the subject of attention and ongoing reform in Germany's administrative and legal frameworks over recent decades. Particular attention has been paid to reconciling the autonomy of the various government entities with the need for consistency and comparability of public accounts.

Step by step, since 1993, municipalities have been allowed by the Länder to prepare their accounts on an accruals basis. Currently, the vast majority of municipalities are required to prepare their accounts on this basis.

In 2010, the Budgetary Principles Act was modernized so that all government entities could adopt accrual accounting if they chose. A number of Länder (such as Hamburg and Hesse) have moved in this direction, but there are no such moves envisaged for the federal level.

Having a variety of different public accounting systems poses challenges for uniform monitoring of the public finances at national level, especially by the Stability Council. However, a technical committee established under section Article 49A of the Budgetary Principles Act lays down rules which must be observed – whether cash or accrual approaches are used – in order to facilitate comparability. The same technical committee sets down standards to be observed by those government entities that choose to adopt accrual accounting. These standards broadly reflect IPSAS norms, but are grounded upon the provisions of the German Commercial Code which tends to emphasize the concept of 'prudent value' as distinct from the concept of 'fair value' that is commonly applied in some other jurisdictions.

Since 2012, the German authorities have been participating fully in the ongoing EU-led discussions on a possible European standard of public sector accounting (the so-called EPSAS approach).

Domestically, a revised administrative regulation on assets and liabilities was issued in 2012, requiring a consolidated presentation (in terms of value).

Germany also has a tradition of using cost accounting as a tool of administrative efficiency and management information. The first manual of standards on cost accounting was published / piloted in 1997, and underwent a number of iterative updates based on experience. Most recently the manual was revised in 2013 to give better guidance on the standard chart of administrative accounts, and the

momentum of progress on accounting issues led to the 2010 legislative modernization. The work on standard cost accounting, with its linkages to the concepts of performance monitoring, also led to the initiatives on product budgeting as described in the previous section.

Public-Private Partnerships in Germany

The federal government has historically used PPPs to a very limited extent. However, it has harvested the benefits of other countries' experiences with regards to how it procures, manages and accounts for PPPs. The German governance framework for PPPs is a clear example of good practice and will be

discussed further below. The federal budget provides a clear overview of federal PPP projects in an annex to the budget documentation. The annex lists the project, the expected cost for the budget year, three out years and the

total accumulated cost of the contract. PPPs at the federal level are mainly used for the federal highway sector. There are currently 18 projects with total expenditures of EUR 23 461 million and six projects are making their way through the pipeline currently. There is no particular reporting requirement for PPP projects at the sub-national level, but according to the database operated by Partnerships Germany (Partnerschaften Deutschland-ÖPP Deutschland AG), a total of 187 building and engineering PPPs are in operation as of the end of April 2013. The total volume of these contracts is approximately EUR 7.5 billion. Build-transfer-operate models are the most common type of PPPs in Germany. Given the size of the German economy this constitutes a modest PPP programme as of now.

Procurement and Budgeting for PPPs

In Germany, PPP procurement is used if it is assessed ex ante to represent more value for money compared to the traditional infrastructure investment option

(TIP). Whether such a process is initiated will be based on whether it is prima facie suitable for PPP, especially if the project resembles other projects where PPPs were used with success. The stages of a procurement to cover public sector needs are described in the guidelines for "Economic feasibility analyses for public-private partnership projects" (2006). The guidelines were developed in cooperation between the conference of Länder finance ministers and the federal government.

They set minimum standards for economic feasibility analyses for PPP projects and apply to all sectors. The guidelines are intended to ensure compliance with the principle of efficiency in the public administration. The guidelines set out a multi-stage process in which the most cost-efficient solution for delivering the asset is estimated. The process is characterized by an ongoing accumulation of project-related information culminating in the best possible quantitative estimate of the life cycle costs of two procurement alternatives - PPP or TIP. There are four phases:

1. Phase I specifies the project requirements and sets out the financing options and various efficiency components of the project. It culminates in an initial PPP suitability test. The test determines whether or not to continue pursuing a PPP as a potential, but not final, solution.

2. Phase II includes the establishment of the Public Sector Comparator (PSC) i.e. designing a TIP reference project. It is followed by a preliminary economic feasibility study, and the determination of the upper limit for the budget allocation. At the end of this stage, a decision must be taken on whether or not to issue a PPP tender or revert to TIP.

3. Phase III involves the final economic feasibility analysis in which actual submitted PPP offers are compared with the PSC. If it is determined that the PPP option project represents the most value for money and is economically feasible, this stage concludes with contract being awarded to the overall most attractive PPP offer. Alternatively a decision is made to implement the project using TIP.

4. Phase IV involves project monitoring and controlling throughout the contract period and terminates at the end of the contract. Where appropriate, this phase involves consideration of the use and the implementation of final contractual arrangements. The Federal Court of Auditors can audit PPP projects as any other federal expenditures.

Phase I	Requirement specification, financing and efficiency components of the project	
	PPP-aptitude test	▼ Pre-ruling on whether to pursue a possible PPP solution
Phase II	Establishment of the reference project for the Public Sector Comparator (PSC)	
	Preliminary economic feasibility examination	▼ Pre-ruling for or against a PPP-tender invitation
	Establishing the expenditure limit for the budget allocation	▼ Budget estimation and invitation to tender
Phase III	Final economic feasibility analysis	▼ Final ruling for a contract award
Phase IV	Project controlling	and contracting

Stages of PPP economic feasibility analysis

The line ministry at Federal Ministry of Finance of the required financing. The Federal Ministry of Finance reviews the required financing amounts before the expenditures are included in the government's draft budget. The financing is estimated in the line ministry's budget in the form of a commitment appropriation.

There are no minimum revenue guarantees given to the private party in the PPP from the federal government, but guarantees of this nature are in operation at the Länder level. There are no particular notes or disclosures in the budget documentation of the risks associated with the particular PPP project. This could be considered in tandem with the increase in the PPP programme. Should there arise a need for additional funding to a PPP project the transport sector has a buffer in the form of the revenue from toll roads. This should shield the federal budget process from unexpected demands.

These tolls are by definition allocated to road funding and a shortfall must be covered by a surplus in following years. Problems managing fiscal risks stemming from PPPs may be more prevalent at the municipal level which, are supervised by the Länder. The Federal Ministry of Finance seeks to provide guidance on how to manage PPPs through the standing conference of ministries of finance, the best practice guides and the Partnerships Germany advisory services.

Institutional framework

The Federal Ministry of Finance is the main body for setting and coordinating PPP policy across the Government. It is responsible for PPP strategy, the legal framework and federal and international cooperation. It is also responsible for approving the federal public financial commitments as per its role as the Central Budget Authority. Within the Federal Ministry of Finance, a special PPP-Policy Unit in the Budget Division has the lead role in core PPP policy issues. This includes PPP strategy, legal framework and co-ordination. It is also responsible for assisting units in the Federal Ministry of Finance that supervise line ministry projects from a budgetary point of view, typically by way of participation in the project steering groups and at gate-way reviews as discussed above.

CONCLUSIONS AND RECOMMENDATIONS

(I). Germany has a robust, well-developed system of federal budgeting, which commands the confidence, and respect of key institutional stakeholders. The Federal Ministry of Finance, line Ministries, the Federal Chancellery, parliamentary participants and external experts note that the budgeting system is consistent with sound overall macroeconomic management, and with democratic oversight and accountability. The system exhibits some features of an ongoing transition towards a full top-down budgeting approach.

(II). The debt brake, introduced in 2010, is already well-understood among federal budgeting institutions as an over-arching fiscal rule within which budgetary management is conducted. The rule well regarded among institutional players as providing assurance that the public finances will be managed soundly over the medium term. For it to be effective as a guarantor of fiscal prudence, the following conditions will need to be met:

É the rule will need to be enforced rigorously during all stages of the economic cycle;

É the rule will need to be applied uniformly across all levels of government, in line with the established multi-annual timescale. The public finances of the Länder are very heterogeneous, and fiscal relations across levels of government will need to be monitored carefully to ensure that potential incorrect incentives are managed. The new Stability Council will likely prove to be a useful forum for discussing and coordinating such fiscal relations, although it has very limited formal powers to impose discipline on its individual members.

(III). Top-down budgeting, a necessary complement to the debt brake, has transformed the federal budgetary process so that overall fiscal discipline is now a primary controlling factor during the formulation phase. This change of emphasis accepted by budgetary participants, although line ministries note that sector-specific policies, which could be raised and prioritized during traditional budgetary negotiations with the Federal Ministry of Finance, no longer have the same ability to alter the fiscal policy priorities. This puts an added bonus upon line Ministries to

ensure that their limited resources are used to optimum effect, and upon the Federal Ministry of Finance to facilitate the line Ministries in this regard (see also xi below). The practice (introduced in 2013 and carried forward in 2014) of convening State Secretaries at the outset of the annual budget season, and gaining wider political appreciation of the budgetary constraints and realities, has had positive effects on management of the overall budgetary process. A more structured role for the Federal Chancellery in this political coordination process could be useful in coming years, both in terms of cementing the essential strong relationship with the Federal Ministry of Finance, and in ensuring alignment of the budgetary process with government-wide priorities and planning.

(IV). The medium term dimension of budgeting is strong; with the move to top-down budgeting, the multi-year aspects of budgeting ó exemplified in the Financial Plan which traditionally accompanies the draft budget ó have become more effective in setting the parameters for the subsequent budgeting cycles. In particular, the annual õbenchmark decisionö on broad budget limits is strongly influenced by the figures set out in the previous year's Financial Plan, with necessary updates. The multi-annual rollover of budgetary cycles is, nevertheless, an administrative practice led by the Federal Ministry of Finance; regulating and specifying this practice more formally, reflecting the experience of the initial years, and delineating more clearly the space for new policy initiatives and review, would more firmly anchor the process as a fixed element of the new budgeting system.

(V). Longer-term sustainability challenges are analyzed and reported clearly, although there is scope for integrating policy messages more directly into budgetary policy. The implications of shorter- and medium-term policy options for long-term sustainability could more clearly signaled throughout the policy-making process. Long-term sustainability reports could also be a useful foundation and one possible point of departure for periodic spending reviews.

(VI). Independent economic input to the budgeting process is objective, professional and enjoys the confidence of institutional stakeholders. Germany has a distinctive system for drawing upon diverse networks of high-level economic

expertise, and the independence of such networks firmly embedded as a cultural expectation (notwithstanding close working links with the governmental institutions). A further expert advisory panel has recently been established to service the Stability Council. In light of the experience of the new arrangements over future years, consideration could be given to some streamlining and consolidation so that efficiency and coherence can be maximized.

(VII). The Federal Parliament has an unusually strong and influential engagement in the annual budget process. The system of rapporteurs shadowing particular line ministries, and the powers of the Budget Committee and the Bundestag to adjust the draft budget, are consistent with democratic engagement in resource allocation policy. By tradition, the parliamentary engagement also has regard to overall fiscal prudence. However, the focus on micro-level management of budgetary allocations needs to be balanced with higher-level accountability on the objectives and impacts of expenditure policy. In particular:

É At present, parliament lacks a systematic, routine evidence-base for monitoring the public service impacts of financial allocations. At minimum, the budgetary documentation for each line Ministry should specify concisely the strategic objectives and success indicators for each area of spending.

É While parliamentarians enjoy good access to detailed information from the Federal Ministry of Finance, there is a certain imbalance of analytical capacity at the disposal of parliament in making higher-level assessments of the executive's budgetary policy and its impacts. Some mechanism for addressing this imbalance could be explored, taking account of Germany's established institutions and cultural norms. Apart from the option of an independent Parliamentary Budget Office, other options would include: a re-configuration of the existing independent institutions (or of their mandate) so that they are more directly at the disposal of parliament in addressing broader questions of budgetary policy (see also vi above); and an enhancement of the analytical resources / staffing capacity of the parliamentary administration for this purpose. Such initiatives would also enhance the ability of opposition parliamentarians to scrutinize overall budget policies and

objectives: at present, government deputies enjoy easier access (although by no means exclusive access) to official channels.

(VIII). A user-friendly Summary or "Citizen's Budget" should accompany the budget documentation, complementing the clear information on overall budget figures that is already available on the internet. Apart from promoting transparency within a budget process which is both highly technical and opaque, such an exercise – showing the "big picture" of overall resource allocation policy and objectives – could facilitate parliament in engaging more strongly on the macro/strategic as well as the micro/line-item elements of budgeting.

(IX). Capital budgeting in Germany is managed well, and the use of private financing options conforms well with the OECD Principles on Public Governance of PPPs. Germany uses an iterative approach, whereby capital investment projects are subject to increasing levels of scrutiny of their overall societal cost/benefit and various financing options. With the active participation of parliament, political preferences are allowed to play an appropriate role in project selection. Private financing of infrastructure is rightly perceived as a method for procuring capital assets that should only be used when it represents value for money, not as an alternative form of borrowing. The Federal Ministry of Finance's efforts to disseminate best practice on PPPs appear to be working well. There may be an opportunity to strengthen the transparency of the various risks associated with large infrastructure projects. Indeed, this effort may become even more important in the future as the debt brake could make off-budget borrowing more attractive to sub-national governments.

(X). The marked autonomy of line ministries and executive agencies should be matched with greater performance management capacity to ensure that resources are being used effectively and efficiently. The routine "efficiency analyses" conducted within ministries will need to be upgraded to provide meaningful, comparable information on policy choices and prioritization for policy-makers. The work of the Federal Court of Auditors, which is the chief independent resource for identifying inefficiencies, should be developed more

systematically within the management information systems of ministries and their agencies with a view to highlighting good and bad performance.

(XI). New tools and procedures should be developed to counter the risk of rigid, formulaic annual budgeting and execution, and to create fiscal and policy space for emerging priorities such as climate policy, energy policy and longer-term management of health costs. In particular, systematic tools need to be developed for the review, re-prioritization and re-allocation of spending so that Ministries can manage their fixed resources more efficiently, and plan for the achievement of medium-term objectives, in the context of top-down budgeting. To facilitate these objectives, the following initiatives would be beneficial:

a. Political priorities should clearly signaled from the outset of each legislative period, either

via the "Coalition Agreement" or in a separate strategic reference document, so that all ministries have a good understanding for how sectoral policies inter-link with national and government-wide planning and goal-setting.

b. Line ministries will require stronger evaluative capacities (or access to such capacities), in particular associated with the budget divisions, and this will likely require changes in the skills profile of staff.

c. In parallel with this development, the Federal Ministry of Finance should reinforce its capacity to co-ordinate and promote the use of CBA and other evaluative tools across government – not just within the capital budgeting area, where these tools are already well-established.

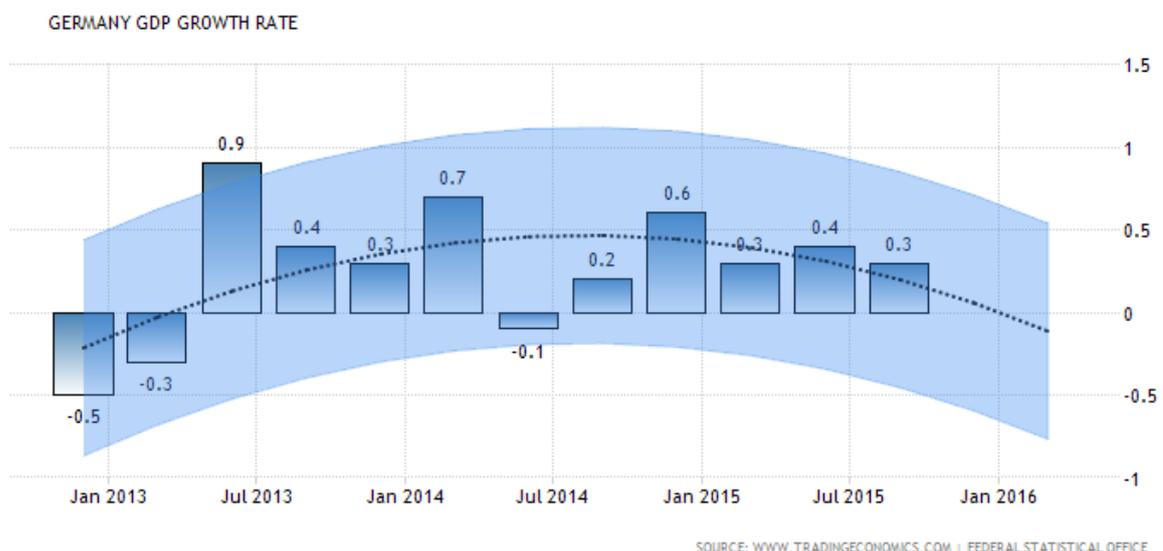
d. As part of the budgeting process, line ministries should be responsible for evaluating and prioritizing within their spending ceilings, and bringing forward evidence-based options for reallocating resources each year. Tax expenditures relevant to their areas should also be encompassed within these reviews, in co-operation with the Federal Ministry of Finance as appropriate.

e. At least once every legislative period, the Federal Ministry of Finance should coordinate a government-wide review of expenditure, to allow (in principle) for evidence-based reallocation across the main policy areas, and making clear the

higher-level trade-offs upon which the government must decide – including the overall balance between expenditure and tax policy. This strategic review should draw upon, and supplement, the more regular efficiency reviews conducted by the line ministries. Government-wide reviews of this nature are only effective when aligned with political demand, so it is essential that the Federal Ministry of Finance coordinate with the Federal Chancellery in securing government buy-in for this approach.

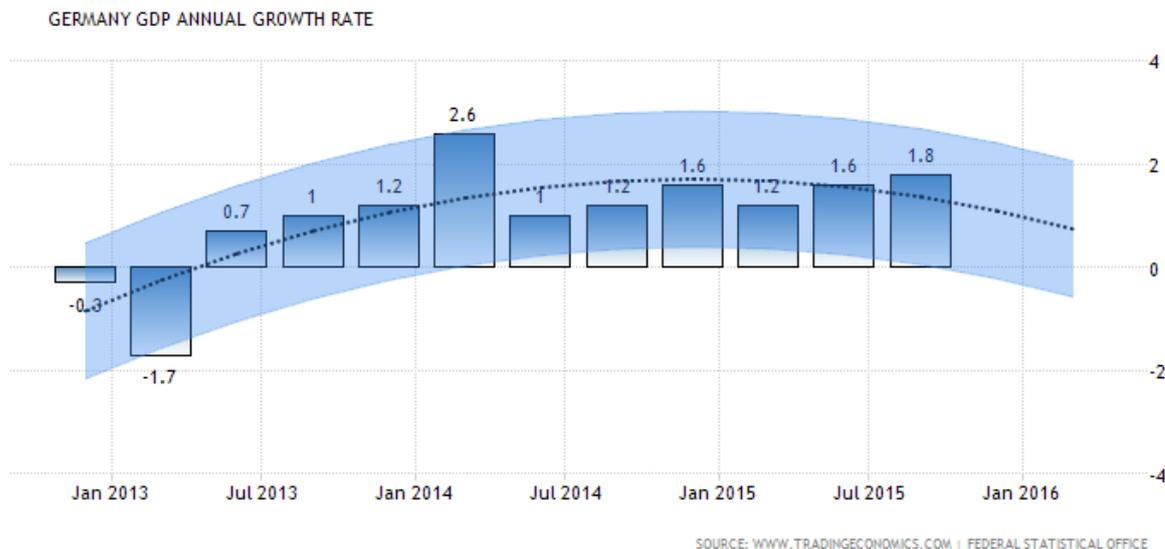
and caution over coming years. It is possible that the Stability Council, and its expert advisory panel, could play a role in the identification, discussion and management of fiscal risks arising across the various levels of government.

GDP Growth Rate in Germany is expected to be 0.30 percent by the end of this quarter, according to Trading Economics global macro models and analysts' expectations. Looking forward, we estimate GDP Growth Rate in Germany to stand at 0.50 in 12 months' time. In the long-term, the Germany GDP Growth Rate is projected to trend around 1.00 percent in 2020, according to our econometric models.



GDP Annual Growth Rate in Germany expected to be 1.30 percent by the end of this quarter, according to Trading Economics global macro models and analysts' expectations. Looking forward, we estimate GDP Annual Growth Rate in Germany to stand at 2.00 in 12 months' time. In the long-term, the Germany GDP

Annual Growth Rate projected to trend around 2.90 percent in 2020, according to our econometric models.



(XII). Fiscal risks, which might endanger compliance with the fiscal rule over time, should be systematically identified and managed, drawing upon the extensive information that is already available throughout the budgetary cycle. This is particularly relevant in the case in the Länder where the traditions of budgetary prudence and stability are not uniform, and where incentives could potentially arise to use non-transparent financing mechanisms, in a context where the scope for more traditional financing has become more constrained. More generally, while the benefits of the new top-down budgeting system and the debt brake seem to be well appreciated, the potential risks and unintended opportunities for gaming the system are not yet well-understood, and should be addressed through stronger institutional prudence

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