



# OECD Journal on Budgeting

- Budget Review: Germany



OECD Journal

# OECD Journal on Budgeting

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## Foreword

**T**he OECD Journal on Budgeting is a unique resource for policy makers, officials and researchers in public sector budgeting. Drawing on the best of the recent work of the OECD Working Party of Senior Budget Officials (SBO), as well as special contributions from finance ministries of member countries and from other practitioners, the Journal provides insights on leading-edge institutional arrangements, systems and instruments for the effective and efficient allocation and management of resources in the public sector.

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## Budget Review: Germany

*Budgeting in Germany at the federal level is conducted in the basis of a well-developed legal, constitutional and administrative framework. The German budget process is robust and encompasses all elements of modern budgeting with significant reforms continuously being implemented . As a result, Germany has achieved an enviable fiscal performance in recent years. Surprisingly, little literature and research is available on the German budget process internationally. GOV/BUD's recently conducted budget review of Germany aims to present a concise overview of budgeting in Germany.*

### **Note on terminology**

In this report...

**“Federation”** refers to the federal level of government, as distinct from the states/regions known as the Länder

**“National”** (e.g. “national budgeting system”) includes both the federal and the Länder levels

**“Government entity”** refers to either the federation or a particular Land as the context may require.

## Summary overview

**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 co-ordinates 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 – depending on the

type of risk – 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 co-ordination 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 co-ordination 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, re-evaluation and re-prioritisation of the baseline allocations. Periodic spending reviews, as practised 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.

## 1. Budget institutions and processes

### 1.1. The legal context

Germany is a federal parliamentary republic, with laws and key institutions of state grounded upon a **Basic Law** (*Grundgesetz*). This Basic Law lays down certain fundamental requirements of the budget process, and prescribes the fiscal relationship between the federation (i.e. the federal level of government) and the state regions (*Länder*) which enjoy a high level of autonomy. The *Länder* also participate in the legislative process of the federation through their representation in the *Bundesrat* (upper house of the bicameral legislature). Some key aspects of the national budgeting system as set out in the Basic Law are:

- The federation and the *Länder* are autonomous on managing their budgets, which should in principle be balanced, and they must work jointly to fulfil EU-related obligations as regards fiscal discipline.

- Each level of government (federal and *Land*) should in principle finance its own expenditure, although there are specified grounds upon which financial aid may pass from the federal to *Land* level.
- Within the federal government, each ministry is independently responsible for the conduct of its own affairs.
- Principles are laid down for the raising of specific forms of taxation, and the apportionment of taxation, at federal and *Land* levels.
- The “debt brake” rule to strengthen and operationalise the balanced-budget principle is also included (since 2009) in the Basic Law.

Budgeting matters are specified in more detail in the body of primary and secondary legislation, as listed below.

- **Budgetary Principles Act** (Act on the Principles of Federation and *Länder* Budgetary Law) – *Haushaltsgrundsatzgesetz (Gesetz über die Grundsätze des Haushaltsrechts des Bundes und der Länder)*: This fundamental piece of legislation establishes the principles of budgeting with which the federal and *Länder* budget rules must comply. Among the principles are financial sufficiency and necessity; annuality; efficiency and economy; and universality (see also Box 1– Principles of Budgeting in Germany). The Act allows for either cash or double-entry accounting systems to be used, and permits carryover and virement of expenditures in certain circumstances. It prescribes that the budget be allocated by departments, which in turn are divided into chapters and titles. The Act also envisages “commitment appropriations”, i.e. authorisations which involve a commitment to spend money in future years (beyond the budget year) – such appropriations require the prior consent of the respective Ministry of Finance.
- **Federal Budget Code** – *Bundshaushaltsordnung*: This document applies the Budgetary Principles Act to the budget of the federation, and thus provides the basis for the annual procedure for presenting and authorising the budget, as well as budget implementation and maintaining and auditing accounts. There are additional specifications for virement, and a requirement that the annual budget be accompanied with a “finance report” i.e. a report on the current state of the public finances and their outlook. The Code also provides for the “blocking” of certain budget items, so that they may not be drawn down for expenditure without express authorisation from the Federal Ministry of Finance.
- **Act to promote economic stability and growth** – *Gesetz zur Förderung der Stabilität und des Wachstums der Wirtschaft*: The Act, which dates from 1967, lays down a principle that federal and *Land* budgets shall “observe the requirements of overall economic equilibrium”. It provides *inter alia* that the Federal Government present an annual economic report to the *Bundestag* in January of each year, which should include a response to the most recent Annual Report from the Council of Independent Economic Experts. An important feature of the Act is the stipulation that the federal budget be managed on the basis of a rolling five-year planning period, and that a Financial Plan be set out each year by the Federal Ministry of Finance. This Act also envisages that a reserve fund be established for counter-balancing cyclical fluctuations, a provision that has been disused and is now superseded by the debt brake provisions.
- **Federal Court of Auditors Act** – *Gesetz über den Bundesrechnungshof (Bundesrechnungshofgesetz)*: This Act establishes the Federal Court of Auditors as a “supreme federal authority” with independent responsibility for government audit.

### Box 1. Principles of budgeting in Germany

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 (see Section 2.1) 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.

- **Stability Council Act** (Act on the Establishment of a Stability Council and on the Avoidance of Budgetary Emergencies) – *Stabilitätsratsgesetz (Gesetz zur Errichtung eines Stabilitätsrates und zur Vermeidung von Haushaltsnotlagen)*: This Act establishes the Stability Council, composed of the federal and *Länder* ministers for finance and the federal minister for economics. Its purpose is to co-ordinate national fiscal policy across levels of government with a view to avoiding budgetary emergencies, and it provides for surveillance and “rehabilitation” procedures to address any vulnerability for government entities in this regard.
- **Consolidation Assistance Act** – *Konsolidierungshilfengesetz (Gesetz zur Gewährung von Konsolidierungshilfen)*: This Act provides for a fixed amount of financial assistance to five *Länder*, financed from the federation and the *Länder*, subject to conditionality including the elimination of the structural deficit in those five *Länder* by 2020 (i.e. from when the debt-brake prohibition on non-cyclical borrowing becomes fully applicable to them).

- **Article 115 Act** (Act on the Implementation of Article 115 of the Basic Law) – *Artikel 115-Gesetz (Gesetz zur Ausführung von Artikel 115 des Grundgesetzes)*: This Act applies the debt brake provisions of the Basic Law to the federal budget. In particular, the Act outlines how the cyclical component of the budgetary position is to be calculated, and provides for the “control account” for correcting deviations from budgetary plans.
- **Article 115 Ordinance** (Ordinance on the Procedure for Determining the Cyclical Component under Section 5 of the Article 115 Act) – *Verordnung über das Verfahren zur Bestimmung der Konjunkturkomponente nach § 5 des Artikel 115-Gesetzes (Artikel 115-Verordnung)*: This ordinance gives further technical specifications for the calculation of the cyclical element of the federal budget, relating in particular to the measurement of the output gap and of the sensitivity of the budget to GDP changes.

In summary, the legal basis of the budgeting in Germany is quite comprehensive, clear and distinct, and shares many of the characteristics of other OECD countries.

## 1.2. Annual budget process

The federal budget consists of the annual budget act and its appended budget documentation. The budget documentation is very extensive and detailed and it includes numerous summary and aggregate tables, as well as clarificatory notes (some of which have binding effect) – see Box 2 below.

### Box 2. The federal budget

Under the legal and constitutional provisions (see Section 1.1 above), the federation must adopt a Budget Act each year setting out its expenditures for the year ahead and how they will be “covered” (financed) through revenues and any necessary borrowing. The draft Budget Act is presented to, debated, amended and approved by, the *Bundestag* (see Section 6): the consent of the *Bundesrat* (the upper house of parliament in which the *Länder* are represented) is not required (cf. Section 6.4).

Formally, the federal budget consists of the annual **Budget Act** and its appended budget documentation. The budget documentation contains a complete set of budgetary information set out according to the schema outlined below.

**Aggregate Budget:** the sum total of all of the individual departmental budgets, along with collective revenues, and a borrowing plan to cover any financial gap. This part of the budget also shows the official calculation of the maximum permissible borrowing amount under the debt brake rule (see Section 2.1).

**Departmental budgets:** The bulk of the budget detail is set out in the departmental budgets, which contain the expenditures, revenues, “commitment appropriations” (see Section 1.1 above) and established posts for the federal ministries and other key offices/ areas – each of these areas or “departments” (there are 22 at present) has a two-digit budget code as listed below.

- 01 Federal Presidency
- 02 *Bundestag*
- 03 *Bundesrat*
- 04 Federal Chancellery
- 05 -12, 14 -17, 23, 30 Federal ministries
- 19 Federal Constitutional Court

### Box 2. The federal budget (cont.)

20 Federal Court of Auditors

32\* Federal Debt

60\* General Revenue

In turn, the departmental budgets are broken down into **chapters**, which correspond to the main programmatic areas and subordinate agencies of the line ministry; and these in turn are divided into **titles** or line items, which are sorted into the expenditure items and revenue items relating to that specific area. The **purpose** that is designated for each expenditure title has legally binding effect. Some titles may be combined into **title groups** where they relate to a common purpose (e.g. IT expenditure), and they are tagged accordingly in the budget coding system to facilitate the budget flexibility arrangements (see Section 1.5). The financial detail is supplemented with budget **notes**, some of which have binding effect in specifying or restricting the uses of the funds. The departmental budgets are supplemented with numerous **budget summaries**. Finally, from the 2013 budget onwards, some departmental budgets and chapters are accompanied by a one-page **foreword** to provide the strategic context for departmental activities and objectives (see Section 3.2).

The 2013 federal budget is 2 998 pages long and contains approximately 6 600 line items.

\* Departments 32 and 60 come within the purview of the Federal Ministry of Finance.

Under the federal budget code, the Federal Ministry of Finance is responsible for organising the annual budget preparations. It frames the overall budgetary aggregates, proposes allocations for each line ministry (on the basis of continuity with the indicative allocations from the previous cycle), receives “bids” from each ministry, and has the right to amend and adjust these bids (after consultation with the ministries concerned) to ensure consistency with the overall budgetary constraint.

On the basis of official-level discussions, which get under way in December of year  $n-2$  (i.e. in the calendar year that is two years prior to the year  $n$  to which the budget relates), indicative allocations are brought by the Ministry before the government in February of each year  $n-1$ . The resulting “benchmark figures decision” (*Eckwertebeschluss*) in March sets the parameters for more intensive discussions among ministers, leading up to the presentation of the government’s proposed budget – the “draft budget” – to parliament in August.

An intensive process of parliamentary engagement then gets underway, involving dedicated teams of rapporteurs from the influential Budget Committee of parliament, who discuss the proposed allocations with the line ministries. The Budget Committee has power to recommend variations in the proposed allocations, and these recommendations are usually fully adopted by the parliament. A reconciliation and settlement process gets underway before the final budget is voted through by parliament in November/December (see Section 7). Box 3 below provides a summary overview of the annual timetable.

During the course of the budget year, line ministries are chiefly responsible for the control and delivery of their budget commitments. While the Federal Ministry of Finance maintains an oversight role, its power to intervene is limited. There are mechanisms open to the Finance Ministry to “block” certain lines of spending before they can be drawn down, and some other powers – e.g. control over *virements* – can also enhance its leverage. There are some mechanisms for flexibility in how funds are used; both in-year *virement* and conditional carry-over mechanisms across budget years.

### Box 3. The annual budget timetable

The budget formulation process is an annual cycle which, in fact, begins two years before the year being budgeted for (in other words, in year  $y-2$  in respect of budget year  $y$ ). While the various activities associated with the budget formulation and approval are multi-faceted (see Figure 1), the essential sequence of budgeting at the federal level can be summarised as follows:

**December** (of year  $y-2$ ): While the formal approval of the Budget Act for the next year  $y-1$  is being concluded in parliament, the Federal Ministry of Finance begins **technical consultations** with the line ministries, inviting them to update the figures in the PFM System for the budget year  $y$ , as well as the figures for the other years previously included in the Financial Plan (see Section 1.4), namely years  $y+1$  and  $y+2$ , and to roll the figures forward to the new incoming “outer year”  $y+3$ . Line ministries can also raise new policy priorities which may have implications for the overall funding envelope, and the Federal Chancellery also makes its views known on priority issues.

**January-February** (of year  $y-1$ ): The government’s official economic forecasts and federal revenue forecasts for the year ahead are finalised. The Federal Ministry of Finance endeavours to accommodate new policy priorities within the permitted resource level. High-priority and contentious issues may be elevated beyond the level of officials to be resolved at the **political level**, i.e. State Secretary level or cabinet level if necessary.

**March**: The cabinet agrees the **Benchmark Figures** setting out the aggregate and sectoral expenditure limits and revenue figures, consistent with the fiscal constraints, and within which the ongoing budget negotiations must be concluded.

**April**: A **Stability Programme**, showing the medium-term development of the public finances, is published in compliance with EU rules. These public finance figures reflect the Benchmark Figures.

**May-June**: **Detailed budgetary discussions** take place between the Federal Ministry of Finance (in particular its “mirror units” and their counterparts in the line ministries) on the detail of their allocations and policies.

**June/July**: **Cabinet decision** on the draft Federal Budget.

**August**: The **draft federal budget is submitted** by the government to the *Bundestag* and the *Bundesrat*, along with the five-year Financial Plan.

**September**: **First reading** of the draft federal budget in the *Bundestag* and the *Bundesrat*.

**September-October**: The Budget Committee of the *Bundestag* considers the draft budget. Rapporteurs from the Budget Committee have detailed discussions with the various ministries on the budget proposals. Amendments and further specifications/conditions may be put forward.

**November/December**: The draft budget goes through second readings in the *Bundestag* and the *Bundesrat*. A final “settlement session” is held in the Budget Committee of the *Bundestag*, at which all outstanding issues must be resolved in advance of the final reading and passage.

**December** (of year  $y-1$ ): The **Budget Act** for year  $y$  is signed into law by the Federal President. Meanwhile the new budget cycle for year for year  $y+1$  will have commenced.

#### 1.2.2. Three “arcs” of annual budgeting

The above overview condenses a myriad of inter-connected processes, involving a range of themes and participants who contribute (directly and indirectly) to the preparation and shaping of the annual budget. The complex sequence of processes can

best be described as comprising three distinct phases or “arcs”, in which budget policy formulation receives inputs from independent sources, progresses internally within the public administration, and gives rise to budget-related documents that feed into the processes of both EU surveillance and parliamentary scrutiny and authorisation. These policy arcs are presented in Figure 1 and are described in more detail below.

**Arc 1 – Towards the annual “Key Figures Decision” and Stability Programme.** As a euro area country, Germany is obliged to prepare a Stability Programme by mid-April each year, showing the medium-term aspects of economic and fiscal policy which are used as a basis of EU-wide budgetary surveillance. The starting-point for this annual process can be traced back to the November of the previous year when the German Council of Economic Experts presents its wide-ranging economic report, including economic and fiscal forecasts. The Council is an independent statutory body and its report is not directly a part of the government’s budget preparation process. However, the government is obliged to respond formally to the Council’s report, and it does so in the Annual Economic Report which is published by the Federal Ministry of Economics<sup>1</sup> in late January each year, and which includes the government’s official economic forecasts for the year ahead.

On the basis of these official macroeconomic forecasts, the Federal Ministry of Finance prepares an internal tax revenue forecast (in the subsequent phases of the budget process, this is replaced by forecasts of the Working Party on Tax Revenue Forecasts – see below). In parallel, and informed by these analyses, the Federal Ministry of Finance draws together its estimate of the national budget parameters for the general government sector. These budget estimates are not merely technical exercises, prepared on the basis of the cost of existing policies, but reflect the constraints imposed by Germany’s fiscal rules framework (see Section 1.3 below).

It is in this context that the Federal Ministry of Finance seeks to accommodate policy pressures and new priorities, as signalled from the political system, within the available resources. The combination of a strong rules-based fiscal constraint which makes explicit the ceiling on resources, and the ex-ante phase of deliberating on political priorities, makes for a distinctive “top-down” style of budgeting in Germany (see also Section 1.3). This process leads to cabinet agreement on the “key figures” or “benchmark figures” decision, including indicative expenditure allocations at the federal level, in March.

The same process which leads to the internal benchmark figures proceeds through to the preparation of the external (i.e. EU-related) Stability Programme. The forecast budgetary aggregates arising from this exercise are notified formally to the European Commission by the end of March as required by EU surveillance rules (this “Maastricht notification” includes outturn figures for the general government sector – debt and deficit ratios – as well as projections for the year ahead). Finally, the annual Stability Programme is produced by mid-April, following the format laid down under EU rules, dealing in particular with public-finance targets for the following year (i.e. the budget year) and into the medium term.

On the basis of this phase of the budget process, the parameters of the annual budget for a given year are firmly laid down as early as March/April of the preceding year. The remainder of that preparation year (i.e. from April to December) is taken up with more detailed specifications of the allocations for each Ministry, with more limited room for adjustment and re-allocation.

**Arc 2 – Towards the Draft Budget and Financial Plan.** As the Stability Programme cycle is being completed, a new round of independent economic forecasts sets the scene for the

detailed budget preparations. The Ministry of Economics commissions a “Joint Economic Forecast” (JEF) from a panel of experts from independent research institutes in Germany. This forecast is not adopted directly by the federal administration, but is an important reference for the preparation of the official Macroeconomic Forecast published in late April. The federal government’s forecasts are compared with the current forecast by national and international institutions. On the basis of this document, a tax revenue forecast is prepared by the Working Party on Tax Revenue Forecasts, an independent advisory council which includes outside economic experts as well as Ministry officials.

In parallel, the line ministries transmit their detailed budget bids – in observance of the constraints set by the benchmark figures decision – on line item level in April. These bids form the starting-point of negotiations between the Federal Ministry of Finance and the line ministries between April and June. On the basis of these discussions, and informed by consultations with the Stability Council (see next paragraph), the federal government decides in cabinet on the draft budget at end of June/beginning of July.

Also in parallel, during June-July, the Stability Council becomes engaged, and the implications of the economic and revenue assessments for national budgetary policy (i.e. for both the federal and Land levels) are discussed at this forum (see Section 2.2). The conclusions feed into the preparation of a “Stability Report” which will go on to be evaluated, and to be considered in the budgetary finalisation process, over the autumn.

This budget draft is submitted to the *Bundestag* and the *Bundesrat* in mid-August and presented before the *Bundestag* (“first reading” of the Budget) in September.

In the general government perspective, the draft Budget is accompanied by the important “Financial Plan” which includes budgetary allocations for each line Ministry for the three years following the budget year (see Section 1.4 below).

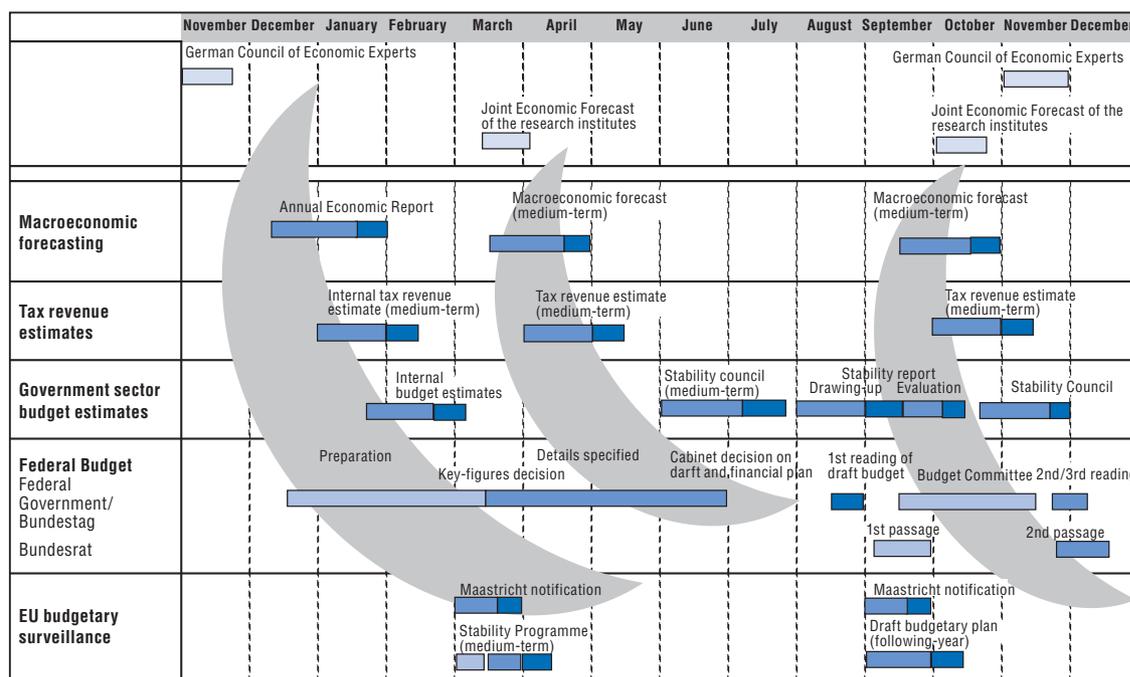
The draft Budget in turn forms the basis for the second Maastricht notification of the year to the European Commission (at end-September) and the draft budgetary plan which must also be submitted to the European Commission by mid-October for consideration under the newly-strengthened EU economic surveillance regime for euro-area countries.

**Arc 3 – Adopting the annual budget.** As fully six months will have passed since the April “Joint Economic Forecast”, a second JEF is commissioned from the independent panel in early October. This initiates a similar sequence of activities as the earlier iteration: an official Macroeconomic Forecast is prepared by an official-led technical panel and a tax revenue forecast is prepared by the independent Working Party on Tax Revenue Forecasts. These materials are the basis for the finalisation of the federal budget documentation, and for government decisions on any final adjustments to the parameters set out in the draft budget.

These analyses, along with the Stability Report, are also considered by the Stability Council which agrees on the co-ordination of national budgetary policy among the federation and the *Länder*.

Meanwhile the draft federal budget, having been published in August, is subject to a first reading in the federal parliament in September. It is then subjected to a detailed scrutiny by the Budget Committee of the *Bundestag* before its subsequent readings and passage into law in December (see Section 6.1).

Figure 1. **Three “Arcs” of federal budgeting in Germany**



Source: German Ministry of Finance.

### 1.3. 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 (see Section 2). 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 2010-13, 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.

### **1.3.1. 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 – in a bottom-up manner – be settled 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-prioritise 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-prioritisation. 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 is discussed below.

### 1.3.2. Scope for re-allocation during the budget formulation stage

In practical terms, it is notable that the effectiveness of Germany's top-down approach to date has been due, at least in part, to the existence of a well-established bureaucratic mechanism for transitioning from one year's budget cycle to the next. Provided that the pre-set course of budgetary policy is aligned with the fiscal constraint (so that the “opportunity cost” of any alternative allocations is readily apparent), this approach to applying top-down budgeting can be most effective in keeping public finances on track as in Germany's case.

Germany however, does have tools at its disposal to introduce adjustments to the pre-set allocations when circumstances call for it. To begin with, as outlined above, there is scope in the initial budget updating phase (December-January) for new priorities to be surfaced and, if necessary, elevated to political level for decision. However, this scope appears limited to incremental or one-off policy proposals, and is not designed to accommodate large-scale,

government-wide reprioritisations. This became apparent in early 2013 when it was acknowledged that significant additional savings would be required in the 2014 budget, and that there was a need for a stronger engagement of the political levels of government to address this. During this event, the State Secretaries of the various government ministries convened for discussions led by the Federal Ministry of Finance. This proved to be a productive way of forming a shared understanding of the task to be addressed. A range of political options were raised and a specific approach was agreed upon including an element of across-the-board savings together with some more targeted measures.

As regards to across-the-board savings, there is an additional mechanism available to the government. As a contingency for circumstances in which savings need to be identified quickly for policy emergencies, the Federal Ministry of Finance has devised a formula, referred to informally as the “expenditure key”, for levying reductions in an equitable *pro rata* manner across all ministries (making allowance, however, for statutorily pre-empted expenditure, so that reductions are as far as possible exacted from “discretionary” areas of spending). Such a mechanism was availed of when additional expenditure consolidation was found to be necessary in 2013 to keep within budget limits and make room for additional spending priorities.

As effective as this technocratic mechanism proved to be, its use illustrates a more general point that Germany does not have well-developed mechanisms for prioritising, and re-prioritising, among its various areas of public expenditure in a routine manner, as is the case in other OECD countries. Such mechanisms could be particularly useful if, for whatever reason, the practice of over-pessimistic forecasts, and the associated expectation of additional resources helping to smooth the annual budgetary process, were discontinued.

### **1.3.3. Top-down budgeting: assessment**

In Germany’s case, the top-down budgeting approach makes for an orderly and efficient conduct of the budget process, with clear visibility from an early stage in the process as to the level of resources available to line ministries. Taken together with the medium-term aspects of budgeting (discussed in the next section), this should in principle allow for budget negotiations to focus upon how to make best use of available resources, with less time dedicated to special pleading for additional resources.

Indeed, most actors within the budget system – including within the central and line ministries – accept that the move to top-down budgeting has brought about a fundamental shift in the balance of power between the Federal Ministry of Finance and the other ministries. The previous “bottom-up” system of budgeting allowed more power to the line ministries, or to the “demand side” of the budget process; nowadays, it is clear that line ministries must prioritise to a greater extent within their annual allocations and their multi-annual plans; whereas fiscal policy is now the determinant, rather than the resultant, of the sector-specific programmes. On the other hand, within their spending envelope, line ministries nowadays have greater freedom, and indeed greater responsibility, to decide on their allocations than in the past.

In more general terms, one criticism that can be levelled at the top-down budgeting approach is that, while finance and economic ministries may see the case for the primacy of macro-fiscal rectitude, it may not be obvious to other ministries or to the public in general why fiscal policy should take precedence over health, education or other aspects of social and economic policy, in particular in times of retrenchment when difficult and sensitive

choices fall to be made. Nevertheless it seems clear that, in Germany at least, a very high value is placed upon the virtue of fiscal soundness and stability, and the pre-eminence of macro-fiscal policy is not seriously disputed among other line ministries. Indeed, the fact that the Basic Law was amended in 2009 to put the debt brake rule on a constitutional footing – something which required the approval of two-thirds of the parliament – provides a democratic mandate for budgets to be framed within a clear fiscal constraint.

It should be noted however that top-down budgeting, while in many respects a defining characteristic of modern budgeting in Germany, and arguably a necessary operational complement of the fiscal rule, is not at present reflected in the legislative framework (which regulates so many other aspects of the budget process). This omission is something that policy-makers may wish to address, to ensure firm and enduring legitimisation of this aspect of budgetary governance.

A related point is that top-down budgeting and fiscal planning depend, for their continued effectiveness, on the accuracy and reliability of budgetary forecasting including those forecasts being brought forward by the line ministries during the technical budget preparation stage.

#### **1.4. Medium-term dimension of budgeting**

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 and that is reflected in the “benchmark figures decision” that guides the budgetary process. It is important to note that the benchmark figures set down allocations not only for the budget year, but for the entire multi-annual planning period. The Stability Programme, which Germany produces in mid-April along with other euro-area countries, includes multi-year projections for the public forecasts, consistent with the benchmark figures. For domestic planning purposes, the primary reference document is the Financial Plan which is traditionally produced as part of the annual budget process, and which plays a key role in ensuring continuity of medium-term fiscal planning from one annual budget cycle into the next.

The production of the Financial Plan is required under the 1967 Act to Promote Economic Stability & Growth, and contains fiscal projections and plans for a five-year period – the current year, the upcoming budget year, and the following three years. The Financial Plan is adopted by the federal government and submitted to parliament alongside the draft budget in August each year.

The Financial Plan, coming late in the budget formulation process and submitted formally to parliament, is a living policy document drawing together a number of separate but related strands of budgeting that concern the multi-annual dimension. The multi-year allocations from the government’s benchmark figures decision of March are repeated, adjusted and updated as necessary to reflect developments and negotiations. The underlying figures at line-item level have, by the time of the Financial Plan, been settled at the official level for the full five-year period of the Plan and for the upcoming budget year. They are identical with the budget approved by cabinet at the same time.

The overall fiscal aggregates in the Plan must also be consistent with the requirements of the fiscal rule. Article 115 of the Basic Law requires that the annual budget comply with the debt brake rule; while this requirement does not apply formally to the Financial Plan itself, this is a *de facto* requirement. To achieve this objective, the Plan must be negotiated by the Federal Ministry of Finance with line ministries, in a manner that takes account of

existing and developing priorities including their multi-annual cost implications. The multi-year expenditure projections brought forward from the previous year's budget cycle (including through the benchmark figures decision in February/March, the Stability Programme projections from April and through to the draft budget itself) must therefore also be aligned with the overall multi-annual fiscal constraints. These multi-annual projections in turn form the basis for the subsequent year's budget formulation process, which gets underway shortly after the Financial Plan itself is published. In this manner, the "opening position" for expenditure in each line ministry will be consistent with the fiscal rule, subject to economic forecast changes that may require a recalibration of the budgetary aggregates.

The above approach is distinct in some respects from the type of medium-term expenditure framework or multi-annual ceilings that are used in other OECD countries. It is notable, in particular, that the Financial Plan is not represented as being "binding" in any formal sense upon the budgetary processes and decisions that come in subsequent years; nor is the document formally approved by parliament, being presented for information purposes only. However, in practical terms, the Financial Plan embodies a series of decisions and commitments relating to the conduct of fiscal policy over the medium term, and as such it shows limited scope for discretion or ambiguity. Once the Financial Plan is laid down and agreed by government, it assumes significant influence over the shape of future budgetary policy, unless some external "shock" disturbs the planned course.

This approach is closely related to the top-down budgeting mechanism, in that it carries forward a profound, inherently bureaucratic momentum, and it therefore carries a similar profile of benefits and risks. Multi-year financial planning in Germany is fixed, clear, orderly and provides for a coherent and integrated overall approach. On the other hand, there is a limited window of opportunity to take stock of the medium-term strategy or to adjust multi-year budgetary allocations in line with evolving priorities. Moreover, there are no clear incentive mechanisms for ministries to be innovative and proactive in identifying savings since they cannot readily retain any such savings for their own net benefit (see next section).

### **1.5. 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 organisations. 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 draw-downs 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.

#### **1.5.1. Flexibility within the budget implementation phase**

Budget allocations are annual, not multi-annual, and managers are 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. Authorisation of such supplemental appropriations by the Federal Ministry of Finance is not a routine matter: the additional funds may be authorised 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,<sup>2</sup> 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 – 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 "bedded in".

**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 prioritise within their overall allocations and to pay special attention to timely budget execution. On the other hand, the incentives for managers to realise 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 "cover the use" of such funds through offsetting revenue or savings measures.

## 2. Conduct of fiscal policy – National and sub-national aspects

### 2.1. Overview of national fiscal policy

The major budget reforms of 1967-71 included a strong macroeconomic dimension, recognising 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 4 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.

#### Box 4. Overview of the EU Economic Governance Rules

The key elements of the EU economic governance framework applicable to most (but not all) EU countries, following the reforms of 2011-13, can be summarised as follows:

##### **Countries must manage their public finances within fixed limits**

The debt level and the deficit level must not exceed ceilings of 60% of GDP and 3% of GDP respectively; both expressed in general government terms.

The public finances should be maintained close to a balanced position (i.e. a deficit of no more than 0.5% of GDP) in cyclically-adjusted terms, net of one-off factors.

The growth in public expenditure must not exceed the underlying medium-term level of economic growth, unless it is financed by additional revenues.

##### **If these limits are not respected, budgetary correction must proceed at a minimum pace**

Any unduly high non-structural budget deficit (i.e. not close-to-balance) must be corrected by 0.5% of GDP each year, in structural terms; while any excess above the debt limit of 60% of GDP must be reduced by 1/20th each year.

##### **Exceptions to these rules are very limited**

Countries may deviate from, and delay compliance with, these fiscal limits in the event of a sudden severe economic shock, provided that they are making satisfactory fiscal effort in structural terms.

##### **The fiscal limits must be enshrined in national constitutions or laws**

Numerical fiscal rules, consistent with the above targets, should be adopted in national laws or constitutions.

##### **There are financial penalties for non-compliance**

Sustained failure to comply with the fiscal commitments leads to an escalating process of “recommendations” and sanctions, culminating in financial penalties.

Under new voting rules, it is harder for member states to block decisions on these matters

##### **Co-ordination of national budgetary calendars**

As well as preparing medium-term Stability or Convergence Programmes in April of each year, countries should submit a draft annual budget in October of each year for consideration at EU level prior to being adopted at the national level by year-end.

##### **A role for independent fiscal institutions**

Within each country, an independent fiscal body should monitor compliance with the fiscal rules, and should be responsible for preparing (or endorsing) national economic forecasts.

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 (see Section 1.4 above).

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 2011-13<sup>3</sup> (see Box 5 below). 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.

#### Box 5. 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 – 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 co-ordination 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), "balance" 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*.
- **Symmetrical adjustments over the economic cycle:** Automatic stabilisers 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.
- **Underlying, not artificial, budget position:** "Financial transactions" 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.

### Box 5. Germany's Debt Brake (cont.)

- **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 “control account” which must be balanced over time. (Deviations arising from unanticipated cyclical changes are not so booked: it is assumed instead that these issues will be covered through re-calculated automatic stabilisers.) Redemption of the control account is required once it reaches 1% of GDP; however, to limit pro-cyclical effects, redemption may be deferred during a downturn, and is in any event capped at 0.35% of GDP even during an upturn.
- **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 amortisation plan to repay the borrowings “within an appropriate time period”.
- **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.

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 6). The rule was the centrepiece of a package of fiscal-responsibility reforms introduced at the time, including federal assistance for progressive budget consolidation in the *Länder* (see Section 2.3 below). 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.

Similar to the debt brake rule used by the Swiss Confederation, compliance with the balanced-budget requirements is supposed to be effected *ex post*, as well as planned for *ex ante*, through the use of a “control account” which logs deviations from public finance targets and which must be reduced according to an amortisation schedule. While the control account is a strictly notional device – it does not hold or owe funds but merely records the deviations from the maximal permissible structural net borrowing – it should in principle be influential in setting the outlines of fiscal policy from year to year. However, it remains to be seen how effective this aspect of the framework will be in practice. Over recent years, the control account has in fact accumulated a large surplus (of around EUR 85 billion in 2013) reflecting better-than-forecast public finances. Partly to address this matter, a federal law was introduced on the initiative of the government in 2013 to drain the control account of its large surplus at the end of the transition period in 2015 (see Box 6). As of now, the debt brake commands respect among policy-makers across the public administration as a binding constraint upon fiscal policy, and as such lays a firm framework for the development of the annual budget and medium-term planning. However, there are a number of aspects of the operation of the debt brake that will need to be monitored closely over the coming years, as outlined in Section 2.4 below.

**Box 6. Allocation of EU Financial Sanctions under Article 109(5) of the Basic Law**

Where financial corrections have effect over more than one Land, the federation and the Länder bear these costs at a ratio of 65:35 per cent.

The Länder as a whole “in solidarity” bear 35% of the charges incumbent on the Länder according to the number of their inhabitants; 65% of the charges incumbent on the Länder shall be borne by the Länder according to their degree of causation.

Details shall be regulated by a federal law which shall require the consent of the Bundesrat.

## **2.2. Co-ordination of budgetary policy across levels of government**

Article 109 of the Basic Law establishes that “the Federation and the Länder shall be autonomous of one another in the management of their respective budgets”, but adds that they shall perform jointly the obligations of the Federal Republic of Germany resulting from the corrective arm of the Stability and Growth Pact. To complete the picture, the approximately 13 000 municipalities (local authorities), which in functional terms are part of the Länder, nevertheless have a right to local self-governance under Section 18 of the Basic Law, a right that has implications for budgetary management.

To reconcile the principles of autonomy and joint responsibility, the 2009 package of reforms established a new national framework for co-ordinating fiscal policy across the government as a whole. In particular, the Stability Council Act (*Stabilitätsratsgesetz*) established the Stability Council as a new body bringing together the finance ministers of the federal government and each of the Länder governments, along with the federal minister of economics. The Stability Council replaced the previous Financial Planning Council which had been established as part of a package of budgetary reforms in 1969, and which had been strengthened in 2002 in light of the provisions of the SGP (as those provisions stood at the time).<sup>4</sup> The Stability Council meets twice-yearly,<sup>5</sup> and is tasked with monitoring the budgets of each of the government entities on a regular basis, and implementing a “budgetary rehabilitation” procedure where a “budgetary emergency” is in prospect.

For mutual surveillance purposes, the Council itself agrees on a set of budgetary indicators, forecasts and threshold values which act as warning signals (see Box 2.4 below). A budgetary report including these indicators is produced annually for consideration by the Council, and a full review may be initiated where the indicators show the danger of a budgetary emergency, or where the government entity itself so requests. The review determines whether the entity is in fact “threatened with a budgetary emergency”.

If such a status is found, the Council must agree a budget rehabilitation procedure with the entity. Like the budgetary correction procedure that applies under the SGP, the rehabilitation procedure is multi-annual in character (five years as a rule), and it includes proposals for annual reductions in net borrowing. Unlike its SGP counterpart, the rehabilitation procedure has no direct enforcement mechanism: it is a matter for each government entity to implement the procedure “on its own responsibility” and it simply reports progress to the Council every six months. In the event of non-compliance, the Council has no powers other than to call for enhanced rehabilitation or to agree a new procedure.

In and of themselves, therefore, the Stability Council's workings serve to promote a shared understanding of the scale of budgetary challenges facing the nation as a whole and the federation or the *Länder* individually, and to agree plans for addressing such issues; compliance is a matter of peer discussion rather than tangible sanctions. However, the Council's operations should also be seen in the context of Article 109(5) of the Basic Law which specifies how any financial penalties arising under the SGP will be allocated across levels of government (see Box 7). Moreover, several *Länder* are committed to progressive reductions of their debt levels as a condition for receipt of federal assistance (see next section). Taken together, the Stability Council arrangement and the constitutional budget rules should promote a coherent national response to the fiscal constraints, both domestic and EU-related, facing the country.

Given the strong focus of its work on budgetary surveillance and on the calculation of the economic cycle (which is relevant for the debt brake and the SGP), it is important that

### Box 7. Fiscal surveillance by the Stability Council

The Stability Council usually meets in May and December each year. It is chaired jointly by the federal minister of finance and the chair of the *Länder* conference of finance ministers. Decisions of the Council are in practice consensual, with resolutions requiring the votes of two-thirds of the *Länder* and that of the federation; although individual *Länder* are excluded from voting on resolutions affecting them. Decisions affecting the Federation require a majority of two-thirds of all voting members.

In advance of the annual December meeting, each government entity (federation or *Land*) must submit a "stability report" covering a 7-year time horizon: the previous 2 years, the current year and the following four years. In line with Article 3 of the Stability Council Act, the report contains a fixed set of indicators to allow for comparable monitoring of the current budgetary situation, debt-brake compliance and the medium-term budgetary outlook using standard assumptions.

The stability report uses 4 fixed indicators (which were determined by the Council itself), as follows:

1. Structural fiscal balance per capita
2. Credit financing ratio (net borrowing as % expenditure)
3. Debt level per capita
4. Interest-to-tax ratio (interest expense as % of tax revenue)

For each of these indicators, threshold values are in place for the federation (based on compliance with its own fiscal rule) and for the *Länder* (based on a maximum deviation from the average values). These indicators are monitored for each government entity and they are the primary basis for a qualitative assessment of whether a "budgetary emergency" is in place or in prospect; in such cases, a budget rehabilitation procedure must be agreed by the Council in respect of that government entity, including a programme for reduction of net borrowing by that entity. At its meeting in May 2011, the Stability Council determined that a budgetary emergency was threatened in the case of four *Länder* (Berlin, Bremen, Saarland and Schleswig-Holstein), and accordingly the stability reports of these *Länder* are formally reviewed by the Council for compliance with the budgetary targets. In December 2013, the Stability Council noted that the rehabilitation programmes remained on course for two of these *Länder*, but it called upon Bremen and Saarland to step up their fiscal correction efforts.

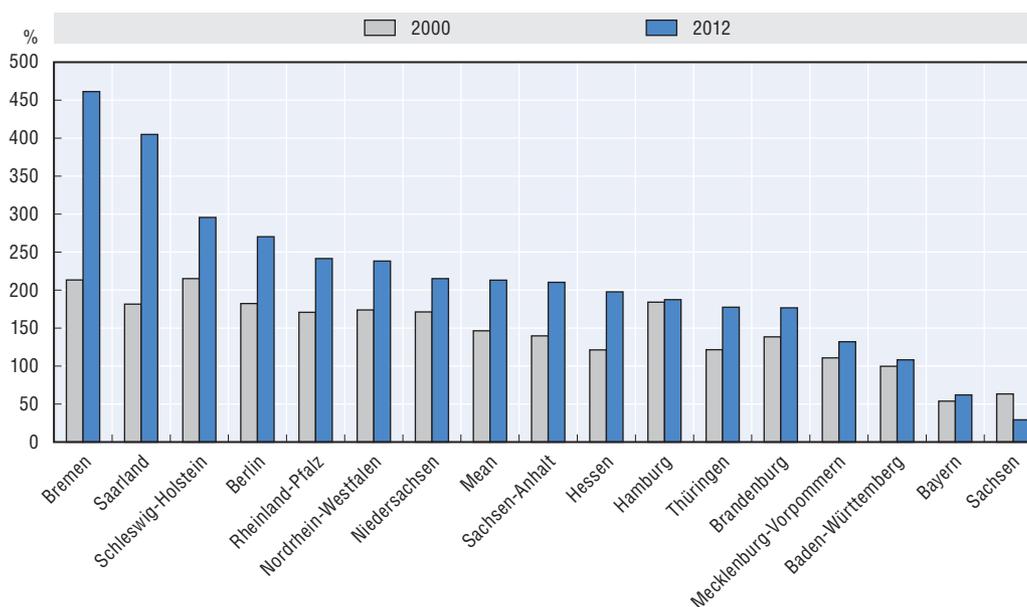
the Council is supported with high-level professional economic capacity. Moreover, given the nature of the Council and the constitutional standing of its constituent members, it is not appropriate for the Council to be dependent solely upon the Federal Ministry of Finance or of Economics in this regard. Accordingly, an expert economic panel has been established since July 2013 to provide such a role, drawing membership from the established networks of independent economic institutions and from the various levels of government. The Chair of this expert panel participates as a speaking observer at meetings of the full Stability Council. Further information about the expert economic panel is set out in Section 4.1.

It should also be noted that there is at present no single accounting standard in place for public budgeting across levels of government in Germany: some *Länder* use accrual forms of accounting, while others and the federation use a cash-based approach. Nevertheless the comparability of data used for the national accounts, finance statistics or by the Stability Council (see Box 7 above) is ensured by Section 49b of the Budgetary Principles Act, which requires the provision of detailed comparable data.

### 2.3. Fiscal consolidation assistance to the *Länder*

The budgetary position of the *Länder* has been quite heterogeneous over the years, and by 2010 the divergences had become quite stark (see Figure 2 below).

Figure 2. *Länder* debt as a share of their revenues (2000, 2012)



Notwithstanding the constitutional autonomy of the *Länder* in their budgetary affairs, Germany's budgetary system is strongly influenced by the principle of solidarity and mutual support (*Bundesstaatliche Solidarität*) among the government entities. The shared responsibility for bearing the financial cost of EU financial penalties, as provided for under Article [104a][109(5)] of the Basic Law, is one example of this; other examples are the provision under Article 104b for financial assistance from the federation to the *Länder* for "particularly important investments" necessary for balanced regional development, including also natural disasters and emergencies, and the provision under Article 107 for

supplementary grants from the Federation to financially weak *Länder*, to make up for any remaining regional disparities in income arising from the operation of the complex scheme of tax redistribution provided for under that Article.

In particular, the Consolidation Assistance Act of 2009 provides for fiscal consolidation assistance amounting to EUR 800 million a year for five of the sixteen *Länder* (Berlin, Bremen, Saarland, Saxony-Anhalt and Schleswig-Holstein) for the period 2010-19. The financial aid is to assist these *Länder* in their budgetary correction path, during the transitional period before the debt-brake prohibition on non-cyclical borrowing becomes fully applicable to them in 2020. The rationale is that these *Länder*, which have a relatively small share of overall population, will face particularly severe adjustment efforts, particularly in light of the scale of debt accumulated over the decades; for their part, the *Länder* involved must commit to progressive elimination of their structural deficits in equal annual decrements in order to qualify for assistance. The law assigns the Stability Council a particular role in monitoring compliance with the deficit reduction programmes, and entitlement to financial assistance lapses for any *Land* that fails to comply with its budgetary objectives.

While the principle of solidarity is far from unqualified,<sup>6</sup> in practical terms the Federation and the *Länder* stand together on budgetary matters and there is a degree of *de facto* joint liability for debts incurred by the *Länder*. At present, as the *Länder* remain on a path towards elimination of structural deficits by 2020, the longer-term risks inherent in such a situation may not be readily apparent. Into the future, compliance with the fiscal rules, and the continued fiscal sustainability of the general government, will depend on sustained fiscal discipline from all levels of government. This will mark a divergence from the pattern of past decades, and it remains to be seen whether the new budgetary framework can effectively underpin such a heightened level of fiscal rectitude.

#### **2.4. Fiscal policy and co-ordination: Summary assessment**

The necessity for co-ordination of fiscal policy across the levels of government has been recognised 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 co-ordination and surveillance mechanisms.

For the new arrangements, centred 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 prioritise 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 signalling issues in budgetary execution. If these risks were to materialise, the debt brake itself would over time become no guarantee of compliance with the EU economic governance rules (see Box 5). Addressing these issues is primarily a matter for the quality and integrity of the budgetary forecasts, which is discussed in Section 4 in particular.

- 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.
- 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 (see Section 1.4 above).

### 3. Resource allocation, planning and prioritisation

#### 3.1. Strategic aspects of resource allocation

Article 65 of the Basic Law establishes the primary responsibility of the Federal Chancellor in determining the “general guidelines of policy”, subject to which each Federal Minister conducts the affairs of his or her department “independently and on his own responsibility”. The Federal Government as a whole “shall resolve differences of opinion between Federal Ministers”. The traditional “collective cabinet responsibility” role is therefore formally restricted to the area of resolving disputes and arriving at consensual positions of government, rather than on deciding on key areas of government strategy (a role reserved for the Federal Chancellor) or on sector-specific policies (a role reserved for the responsible line minister).

The practice in Germany over recent years has been for the parties of government to enter into a Coalition Agreement which outlines the main government objectives for its period in office. There is no separate Statement of Strategy, National Development Plan or other longer-term whole-of-government strategic document as found in many other OECD countries. However, the process of negotiating and agreeing the Coalition Agreement ensures that the government’s broad work programme is reflective of the political priorities of the coalition partners.<sup>7</sup>

A drawback of broad political programmes and statements is that they are not necessarily designed to align with the structure of the annual budget document. Policy-makers and bureaucrats therefore face challenges in assessing how closely the resources

allocated through the annual budget reflect the high-level political priorities, and in deciding how these resources can best be reprioritised and reallocated if necessary. A starting point in addressing such challenges is a clear specification of medium-term political objectives for each area of government, and the introduction of mechanisms that allow the performance of the ministries to be assessed by reference to these objectives. This broad topic remains an ongoing area for development in the German budgeting and planning system.

### **3.1.1. Role of the Federal Chancellery**

The Federal Chancellery is composed of six political directorates, which are in turn broken down into a range of groups and units. Apart from advising the Federal Chancellor on government-wide strategic topics, the units “mirror” the various federal ministries and agencies, in a manner broadly analogous to the “mirror units” whereby the Federal Ministry of Finance keeps abreast of developments in the line ministries. Co-ordination between the centre of government and the various arms of government is facilitated through the office of the Federal Minister for the Federal Chancellery. Given the demands of state upon the role of the Federal Chancellor, it is this Federal Minister who has the primary task of preparing cabinet meetings, and of convening meetings of State Secretaries from the various ministries to resolve outstanding issues insofar as possible.

The Federal Chancellery is also of primary importance in sustaining the political commitment to top-down budgeting, which is not as yet provided for in law (unlike many other areas of budgeting). Top-down budgeting was introduced by administrative and political fiat through the Coalition Agreement of the previous government of Germany (2009-13). Political agreement at the highest levels was judged to be necessary so that the traditional budgeting processes could be transformed to support the agreed national objective of eliminating structural borrowing.

As outlined in Section 1.3, a feature of the new top-down budgeting arrangement is the preparation of a benchmark figures decision in March of each year, setting out the spending envelopes for ministries and for key sectoral areas consistent with the fiscal rules, in advance of the more detailed discussions with ministries about the details of how the allocations will be used. While the Federal Ministry of Finance is the lead ministry in preparing the benchmark figures decision, the Federal Chancellery plays an important background role in engaging with ministries on the qualitative aspects of overall allocations. This involves ensuring that high priorities or newly-emerging priorities of government can be accommodated within the emerging envelopes of expenditure, and managing political discussions for any necessary reallocations. After the benchmark figures decision is taken, however, the Federal Chancellery steps back and does not get involved in the detailed discussions unless particular issues cannot be resolved and must be escalated.

Also as outlined in Section 1.4, the five-year Financial Plan, which was introduced as an element in the 1967 *Act to Promote Stability and Growth*, has assumed a central importance since the introduction of top-down budgeting in terms of mapping out the medium-term evolution of the public finances in conformity with the fiscal constraint. The requirement to keep within these fiscal limits means that when a new political priority emerges,<sup>8</sup> it is more readily apparent that new expenditure demands must be matched with counter-financing (offsetting savings or additional revenues). The Coalition Committee of government, under the leadership of the Federal Chancellor, is therefore engaged from

time to time not just on the task of agreeing new priorities, but in identifying areas which must be de-prioritised in relative terms. In the past, new priorities tended to be settled at the expense of the public purse. Under top-down budgeting within fixed fiscal constraints, however, it is apparent that the influence of the policy divisions within line ministries has increased, at the expense of that of the budget divisions.

### 3.2. Performance aspects of the budget process

As indicated in Section 1.2, the German federal budget document is essentially structured according to ministries or other organisations of the federal government. These ministerial budgets are divided into chapters that mostly correspond to the organisational sub-entities of the ministries. The budget is essentially prepared on a cash and commitment basis with a few variations. The budget document itself is about 3 000 pages long and contains approximately 6 600 line items, each of which is the subject of a formal parliamentary appropriation. The budget can be characterised as a traditional detailed input budget.

Table 1. Specimen of a line item in the budget documentation for the budget 2013

	Proposal 2013 in 1 000 EUR	Proposal 2012 in 1 000 EUR	Realised 2011 in 1 000 EUR
<b>Department: Ministry of Finance</b>			
<i>Chapter: 0812 Ministry</i>			
<b>Personnel of the Ministry:</b>			
Line item: 422 01 Established civil servants	86 423	77 535	76 294

#### 3.2.1. 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:

- **Standardised cost accounting** was introduced in 1997 for selected state agencies and rolled out progressively to other bodies.
- **Flexible budget management** was introduced in 1998 so that administrative resources could be transferred more easily towards areas of greater need (see Section 1.5 above).
- 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.
- In 2003, a **Chart of Administrative Accounts** was first drafted, providing a standardised basis for cost accounting in different areas, whether in the federal or Länder levels.
- In 2006, the **MHR budget modernisation initiative** (*Modernisierung des Haushalts und Rechnungswesens*, Modernising 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.
- In 2010, the **MHR initiative stalled** due to lack of parliamentary support (see below).

The MHR project group took cognisance 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:

- 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.
- For each product, non-financial output measures would be specified.
- 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.
- 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 standardised 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 (see Section 6 for a discussion of the role of parliament in this regard). 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.<sup>9</sup> The parliament consequently blocked the budgeted funds for the reform.

### 3.2.2. Ongoing reform trends

The structure of the German federal budget consequently remains on the traditional format. Within these parameters, and based on past experiences, the Federal Ministry of Finance, and in particular the readjusted MHR initiative “2.0”, have pursued a more modest and focused reform agenda over recent years, with targeted revisions of the budget documentation aimed at enhancing transparency in regard to the broad objectives of government spending and efficiency in implementation.

In order to move in this direction, the Federal Ministry of Finance consulted with the line ministries in 2011-12 to seek their views on what would be helpful to them in presenting their budgets more clearly, clarifying the logic of their financial allocations and drawing attention to the anticipated achievements. On the basis of the feedback received, the intention is to redesign the complex budget document so that it is more readable and usable by parliamentarians.

To achieve this, the following steps are envisaged:

- The budget documentation will include a foreword for each ministerial budget. The foreword will outline the context for the major policy fields addressed in the financial allocations and, in its narrative, will indicate the performance elements that are anticipated to accompany successful implementation. The foreword will be no more than a single page in length.

- Within each ministry budget, each subject chapter will be preceded by preliminary narrative remarks – again no more than one page long – highlighting the main budget indications and performance elements.
- The administrative expenditure will be separately identified but shown below the pure programme expenditure, giving a structure that more readily corresponds with sectoral and functional areas, and facilitating a budgetary analysis that deals with policy matters first.

This reform would be classified at the modest end of the spectrum of “presentational performance budgeting” (see Box 8), and as such falls a long way short of even the pragmatic “performance-informed” budgeting initiatives that have been introduced in several OECD countries over recent years. It should be noted however that the reformed approach was introduced on a pilot basis for three federal ministries in the 2013 budget – Finance, Economics and Agriculture – and the reformed structure was positively received by parliamentarians. As a result, since the 2014 budget, the reformed system is being rolled out to ministries via a step-by-step approach.

#### Box 8. **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.

Source: OECD (2007), *Performance Budgeting in OECD Countries*, Paris, OECD Publishing.

### 3.3. **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 modernised 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 (see Section 2.2 above). 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 emphasise 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 modernisation. 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.

### **3.4. Resource allocation and prioritisation: Summary assessment**

As indicated above, the use of performance information in the budget process within Germany is at an under-developed stage relative to other OECD countries, although reform processes are moving in the direction of a presentational approach with which parliamentarians can feel comfortable. As outlined in Section 6, parliament has an intimate engagement with the details of the financial allocations during the budgetary phase, and in the past that institution has been resistant to changes that would alter this familiar relationship. If the budget process is to serve the interests of citizens in promoting transparency and efficiency regarding the use of financial inputs, it is necessary that the strong tradition of financial scrutiny be balanced – within the Federal Ministry of Finance, within line ministries and within parliament – with attention to the nature and quality of the corresponding non-financial outputs.

Given the strong autonomy of ministries under Article 65 of the Basic Law, it is not necessarily within the power of the Federal Ministry of Finance to devise national programme-based or performance-related frameworks whereby to structure the financial information, or to impose them within the budget document. However, the reform course upon which the Federal Ministry of Finance has embarked holds promise that the value of targeted performance information can prove its worth to parliamentarians, and that progress towards a modern performance-informed budgeting system can be advanced. A collective government-wide impetus towards greater transparency on these fronts, and

support from the Federal Chancellery, would also be effective in overcoming bureaucratic resistance from within line ministries.

It can certainly be argued that the marked autonomy enjoyed by line ministries and executive agencies should properly be matched with greater performance management capacity to demonstrate that resources are being used effectively and efficiently. Experience across the OECD indicates that efficiencies are most readily realised at the levels of line administration and implementation. The work of the Federal Court of Auditors, which is the chief independent resource for identifying inefficiencies, could also be developed more systematically within the management information systems of ministries and their agencies with a view to highlighting good and bad performance (see Section 4.2).

Any reform of the budgetary framework needs to take into account the strength of the line departments and the support they receive from their respective parliamentary committees. A number of countries, notably in Scandinavia, emphasise a “bottom-up” approach to performance information that may be relevant for Germany. In addition, the UK has increasingly emphasised the need for line ministry support for the use of performance information and in the Netherlands, the direct link between funding and performance has been downplayed. There should consequently be good examples that Germany can take inspiration from.

In countries that emphasise a bottom up approach relatively few mandatory rules for the use of performance information in the budget process have been set, as is the case in Germany. Instead the emphasis has been on setting an overall framework in the sense of requiring a few performance measures in the budget documentation and an annual report. The content, the targets and the measurements are up to the line departments. To ensure ownership, the performance framework must be viewed as adding value to the core work of the line department. This will often mean that performance information that is relevant to the operational, agency, level of the departments will be what is primarily produced. While this may not be the most relevant level for the Federal Ministry of Finance or the parliament it does ensure that it is relevant to the operations on the ground. Table 2 below gives some examples of approaches that have been seen as effective in other OECD countries.

**Table 2. A typology of spending reviews and performance evaluation**

Primary objective			
Analysis: analyse management, structures and/or policy to improve efficiency and effectiveness	Create fiscal space: reallocate and/or reduce government expenditure for programmes or organisations		
	Spending Reviews		
Performance evaluation (programme, policy or organisational evaluation)	<table border="0"> <tr> <td style="vertical-align: top;">           Efficiency reviews            Primary criteria: efficiency - Identify how the existing policies can be conducted with less resource            Examples:            Finland “Productivity Programme”(2005-15)            Korea “Self-Assessment of the Budgetary Programme” (2005-)         </td> <td style="vertical-align: top;">           Strategic review            Primary criteria: efficiency &amp; prioritisation – Identify what the government should or should not do            Examples:            Australia “Comprehensive expenditure reviews”; “Strategic review” (2007)            Canada “Programme Review” (1994);            “Strategic Review” (2009)            Denmark “Spending review” (ongoing)            Netherland “Interdepartmental Policy review” (1982; 2009-present)            UK “Spending Review” (1998-present)         </td> </tr> </table>	Efficiency reviews Primary criteria: efficiency - Identify how the existing policies can be conducted with less resource Examples: Finland “Productivity Programme”(2005-15) Korea “Self-Assessment of the Budgetary Programme” (2005-)	Strategic review Primary criteria: efficiency & prioritisation – Identify what the government should or should not do Examples: Australia “Comprehensive expenditure reviews”; “Strategic review” (2007) Canada “Programme Review” (1994); “Strategic Review” (2009) Denmark “Spending review” (ongoing) Netherland “Interdepartmental Policy review” (1982; 2009-present) UK “Spending Review” (1998-present)
Efficiency reviews Primary criteria: efficiency - Identify how the existing policies can be conducted with less resource Examples: Finland “Productivity Programme”(2005-15) Korea “Self-Assessment of the Budgetary Programme” (2005-)	Strategic review Primary criteria: efficiency & prioritisation – Identify what the government should or should not do Examples: Australia “Comprehensive expenditure reviews”; “Strategic review” (2007) Canada “Programme Review” (1994); “Strategic Review” (2009) Denmark “Spending review” (ongoing) Netherland “Interdepartmental Policy review” (1982; 2009-present) UK “Spending Review” (1998-present)		

Source: OECD (2013).

### 3.4.1. Introducing a spending review mechanism

Performance-related budgeting, however, is not a reform that can be implemented alone. A more general difficulty is that the annual budget process, which now operates steadily within the medium-term constraints embodied in the Financial Plan, allows limited space for considered re-appraisal of the overall priorities of government, and for the re-evaluation of the existing stock of expenditure to identify fiscal space whereby these newly-emerging priorities may be accommodated. The process of forming a Coalition Agreement appears effective in identifying high-level priorities; but it is not clear that the existing processes for re-casting expenditure to match these priorities and to adjust them over time are equally effective.

It should be added that such priorities are not only the short-term topics that may arise on the political scene at any time, but longer-term issues – such as those associated with long-term demographic change – which require a well-considered response and which may entail some far-reaching adjustments to existing patterns of resource allocation and use.

Having regard also to the decentralised tradition of the German federal system, it may be advisable for the German authorities to consider supplementing the existing budgetary process with a structured, institutionalised spending review process. (Indeed, a spending review process is envisaged for the federal level in the current Coalition Agreement adopted in late 2013.) Such a mechanism would allow ministries, and government as a whole, to confront more directly and systematically the challenges of budget prioritisation that arise under a binding budget constraint and a top-down approach to resource allocation. Box 9 below presents one example of how such a mechanism might be designed to fit within Germany's federal budgeting system, showing also its potential inter-linkages with other budgetary reform themes.

#### Box 9. Possible Integrated Federal Spending Review for Germany

**Medium-term strategic priorities:** The key national and sectoral priorities outlined in the Coalition Agreement should form the grounding for any spending review conducted at the administrative level.

**Strategic spending review:** The Federal Ministry of Finance should take the lead role in co-ordinating a structured analytical review of existing programmes, with the objective of assessing how well the existing structure of resource allocation corresponds with the government's strategic objectives; in light of the implications of the budget constraint. The assessment should be by reference to objective efficiency and effectiveness analysis as well as a qualitative reassessment of the relative priority of different spending programmes. There are a number of models for:

a) *who should conduct the review* – e.g. analyses conducted by line ministries themselves; by the Federal Ministry of Finance, whether via its “mirror units” or via a specialist cadre of evaluators; or by both in parallel;

b) *who should oversee and steer the review* – e.g. a group of independent experts; the Federal Ministry of Finance itself; a panel of senior civil servants and possibly political advisers; or a sub-committee of the cabinet;

c) *which areas should be reviewed* – e.g. a “comprehensive” approach seeking to cover the bulk of expenditure, or at least the bulk of the discretionary elements of expenditure; or alternatively a more selective and focused review of particular sectors; whether tax expenditures should

**Box 9. Possible Integrated Federal Spending Review for Germany (cont.)**

be included; and to what extent other areas of government action in the sectors concerned – notably regulation – might be encompassed in the evaluation;

d) *what the output of the review process should be* – e.g. a confidential report to cabinet in the context of the budget preparation phase, outlining policy options and trade-offs for consideration; or a public document published alongside the budget, showing the government's conclusions from the review exercise and showing how its medium- and longer-term priorities will be resourced and delivered.

**Linkage to performance agenda:** The review process would highlight how the objectives outlined in the budget narrative (see Section 3.2 above) correspond with the government's strategic plan; and thus the extent to which the budget allocations are supportive of the achievement of these government objectives. The results of this aspect of the review would inform the ongoing reform and developmental processes in this area.

**Linkage to sustainability agenda:** The review could be carried out alongside the analysis that is conducted periodically for the Long-term Sustainability Report (see Section 4.3). In this way, both the medium-term and longer-term issues specific to particular sectors could be dealt with synoptically, and the overall policy messages/budgetary implications could be integrated into the review.

## 4. Quality, integrity, and independent input to budgeting

### 4.1. Independent economic input to the budget process

The German forecasting and budget process allows for a variety of opportunities for independent (or semi-independent) institutions to participate in fiscal policy and budget planning (see Figure 1). These include the:

- Council of Economic Experts (*Sachverständigenrat*, est. 1963);
- The independent economic institutions that are commissioned to produce the Joint Economic Forecast (est. 1950);
- Advisory Board to the Federal Ministry of Finance (est. 1950);
- Working Party on Tax Revenue Forecasting (est. 1955); and most recently the
- Independent Advisory Council (est. 2013) to the Stability Council (est. 2009).

Taken separately and together, the inputs of these institutions foster greater transparency in fiscal and economic policymaking.

#### 4.1.1. Council of Economic Experts (*Sachverständigenrat*)

Established by law in 1963, the German Council of Economic Experts (CEE) comprises of five academic experts in economic theory and economic policy appointed by the Federal President at the suggestion of the federal government for five year renewable terms.<sup>10</sup> Typically the Council members are specialised in different areas, for example, macroeconomics, econometrics, monetary policy, and public finances. Following Germany's corporatist tradition they may also be representative of the views of labour and employer organisations. Council members work on a part time basis<sup>11</sup> but are supported by a full time staff of around 10 economists. The Council also has access to the Liaison Office at the Federal Statistical Office in matters of organisation and statistics (around 10 staff).

In line with its mandate, the CEE publishes an annual report in mid-November on the state of the German economy and expected developments; including opinions on the long-term sustainability of the public finances (minority opinions are fairly common in these reports). Since 2005, the government can request special reports or “Occasional Reports” and may provide additional funding to the CEE to carry out this work. The CEE is also tasked with preparing independent macroeconomic forecasts and long term projections for the public finances of the whole general government sector. As part of its analysis the CEE examines whether the debt brake and other fiscal rules are being followed. While the CEE does not provide recommendations, it may discuss the viability of different sets of options. Indeed a version of the current debt brake was originally proposed by the CEE.

The CEE participates in the Working Party on Tax Revenue Forecasting and as of 2013 a representative of the CEE is also mandated to participate in the Independent advisory council to the Stability Council.

The CEE does not have formal rights of access to information or a memorandum of understanding in this regard. However it is located in the statistical office which facilitates access to relatively good information, including some unpublished data. And the CEE is able to take into account measures announced in the budget in their November forecasts.

The government is required by law to respond to the Council’s annual report in parliament within the eight weeks following its publication. This is done through the government’s Annual Economic Report. Otherwise, the CEE’s authority rests mainly on its ability to influence the public debate. Council members regularly appear in the media and the annual report receives significant coverage.

#### **4.1.2. Joint Economic Forecast**

Since 1950, the Federal Ministry of Economic Affairs has commissioned leading research institutes to produce the Joint Economic Forecast (JEF) on a bi-annual basis in April and October in advance of the government projections. As outlined in Section 1.2, the JEF exercise is an important reference for the preparation of the official Macroeconomic Forecasts published in late April and October.<sup>12</sup>

The JEF covers international and German economic trends. The section on the German economy contains an analysis of the current state of the economy, the most important assumptions of the forecast and an annotated forecast of the key national accounting components. In addition to independent forecasts, the JEF provides independent policy recommendations on fiscal policy (e.g. tax policy) and economic policies (e.g. employment policy, monetary policy) (European Commission, 2011). The JEF also contains a medium-term forecast for developments over the coming five (spring) or six (autumn) years.

Until 2006, the same six institutes tended to participate in the JEF exercise. Subsequently, the system has been changed to introduce a competitive tendering process for three-year contracts. As a consequence, the groupings of institutes participating in the JEF have changed several times and have even included institutes from other countries.

Typically, the institutes and the 60 or so economists that participate in the JEF on their behalf represent a range of viewpoints across the mainstream of economic thinking. Throughout the year, each institute also publishes its own forecasts separately from the JEF. For the JEF, institutes continue to apply their own economic models and analytical approaches in preparing the common forecast. The institutes meet to debate and fine-tune

their results. The final JEF is a joint forecast, but also any irreconcilable differences can be made public through minority opinions. In practice, minority opinions are rare.

Although the participating institutes are given access to some data that is not published, in general they do not have a right of privileged access to government information. The JEF has no direct influence on the budget and the budgetary procedure and the government is not required to incorporate the results of the JEF when preparing its own forecasts for the budget and stability programme, nor is it obliged to publically respond to JEF reports. In practice, although the government forecasts can be characterised as slightly pessimistic, they tend not to deviate significantly from those of the JEF. Given that the JEF is considered to be of high quality and that it attracts significant media attention, major differences in the government forecasts would pose a credibility risk. The government uses the JEF in particular, but also forecasts from other international and national institutions, as a basis to explain any differences that may arise. It should be noted that while the independent forecasts of the JEF and the Council of Economic Experts are similarly well-regarded, the weight of the JEF is somewhat higher due to the timing of its release which allows it to access more up to date information.

#### **4.1.3. Advisory Board to the Federal Ministry of Finance**

Established by ministerial decree around the same time as the JEF, and then on a statutory basis in 1971, the Advisory Board provides the Federal Ministry of Finance with independent advice, analysis, and policy recommendations on fiscal policy. It may also look at regulatory issues and European policy; however it does not undertake its own forecasts or projections. The Advisory Board is free to decide which issues it would like to consider, although it does take into consideration requests from the Minister of Finance.

The Board comprises of around 25 honorary members, typically respected academics with a background in economics, public finance, and fiscal policy. Board members are appointed by the Federal Minister of Finance at the suggestion of the Board. Board members serve unlimited terms, however, the right to vote expires when they reach the age of 70. The Chair and the Deputy Chair are elected by the Board for two-year renewable terms. Board members may hold political posts concurrently but should not represent interest groups. They may also hold positions in other bodies such as the Council of Economic Experts. Secretarial services are provided by staff of the Federal Ministry of Finance.

The Advisory Board has privileged access to confidential information and can consult outside experts. The Federal Minister of Finance or representatives of the Minister may attend any meetings of the Board that they choose. The reports and opinions of the Board are given directly to the Federal Minister of Finance and the Minister determines their publication date, although they must be published within two months. Diverging views may be presented in the Board's reports, and may take the form of minority reports.

Given that the function of the Board is advisory in nature, it does not have any direct influence on the budget or the budgetary process, nor is the government obliged to follow, or respond publically to, their recommendations. However, the Board often chooses to address topics that are likely to attract public interest. The Federal Minister of Finance carefully considers the Board's recommendations and the Board is credited with contributing to political decision-making and the parliamentary and public debate on fiscal policy more generally.

#### 4.1.4. Working Party on Tax Revenue Forecasting

Established following a critical public debate on the government's tax revenue estimates between the Federal Government and the Ifo Institute (a leading economic research institute), the Working Party on Tax Revenue Forecasting is tasked with preparing independent high-quality tax revenue forecasts. Since 1955 the federal government has incorporated the tax revenue forecast of the Working Group into its budget plans, and, since 1968, into its medium-term financial planning. The Working Party's forecasts are also part of the financial projections submitted to the Stability Council.

The Working Party meets in the spring and the fall and is comprised of representatives from the Federal Ministry of Finance (which serves as the central co-ordinator), the Federal Ministry of Economic Affairs, the finance ministries of the *Länder*, the Federal Union of Central Associations of Local Authorities<sup>13</sup>, the Deutsche Bundesbank, the Federal Statistical Office, the German Council of Economic Experts and leading economic research institutes.<sup>14</sup> Its members are appointed by their respective institutions and the Working Party is chaired by the relevant Head of Division in the Federal Ministry of Finance.

The Working Party also maintains a "sub-committee on regionalisation" that is responsible for dividing the tax revenues estimated by the Working Party among the individual *Länder*. The subcommittee is made up of the representatives of the MOF and the *Länder* and is chaired by the Finance Ministry of Baden-Württemberg. The subcommittee's work is not made public.

The Working Party bases its projections on the economic forecast of the federal government. As a rule, it estimates tax revenue on the basis of current tax law, although the fiscal impact of planned changes in tax law must also be taken into account in budgetary and financial planning. When preparing its projections, the Working Party has privileged access to certain inside information.

The five research institutes, the Bundesbank, the German Council of Economic Experts and the Federal Ministry of Finance prepare their own projections for each individual tax independently. These estimates are then discussed within the working party with a view to reaching a consensus. The estimates of the individual taxes are then extrapolated to tax revenues for the federal government, the *Länder* governments, the local authorities and the revenues transferred from Germany to the EU budget.

The Working Party provides high-quality tax revenue forecasts that form the basis of the annual federal budget and medium-term financial planning. Given its immediate relevance to budget planning, it attracts high media attention and is influential in the public debate.

#### 4.1.5. Independent Advisory Council to the Stability Council

The newly established Independent Advisory Council to the Stability Council (see further discussion of the Stability Council in Section 2.2) is tasked with assisting the Stability Council in "monitoring compliance with the upper limit for the structural general-government deficit under Section 51 of the Budgetary Principles Act" (Section 7.1 of the Stability Council Act).<sup>15</sup> If it concludes that the upper limit has not been complied with, it is tasked with making recommendations to eliminate the excessive deficit and the Chair of the Advisory Council will participate in the Stability Council's consultations to ensure recommendations are taken on board. Opinions and recommendations will also be published.

The advisory council is comprised of a representative of the Deutsche Bundesbank, the Council of Economic Experts, one representative from the research institutes involved in preparing the JEF, four experts appointed by the Federation and the *Länder* (two each respectively via their representatives on the Stability Council) and two experts appointed by the national associations of local authorities and the national organisations of the social security funds.

#### **4.1.6. Conclusions on independent economic input**

The role of independent institutions in macroeconomic and tax revenue forecasting fosters debate and consensus building and contributes to prudent and realistic assumptions on the part of the federal government. The estimates of the working party on tax revenue forecasting are adopted by the federal government as a basis for both the annual budget preparation and the medium-term financial planning. And although the government is free to prepare the annual budget and medium-term financial plan using its own macroeconomic assumptions, considerable deviations from the Joint Economic Forecast, for example, would certainly attract media and public attention and require careful explanation.

Taken together the JEF and the recent establishment of the Independent Advisory Council to the Stability Council meets new regulations in the Eurozone that require member states to have independent bodies monitor compliance with fiscal rules and produce or endorse macroeconomic and budgetary forecasts. However some criticism has been levied at the Independent Advisory Council as being constructed with a view to narrowly complying with new EU requirements. More generally, the preponderance of bodies, with their varying degrees of independence and competing voices, at times arguably fail to take into account widely agreed international good practice found, for example, in the OECD Principles for Independent Fiscal Institutions.

## **4.2. Accountability – the role of the Federal Court of Audit**

### **4.2.1. Legal framework and organisation**

The *Bundesrechnungshof* (BRH) or Federal Court of Audit is a fully independent body subject only to law and the 60 or so members of the Court enjoy judicial independence.<sup>16</sup> The BRH draws its legal authority from Article 114 Section 2 of the Basic Law. This is underpinned by more detailed legislation: the Budgetary Principles Act (1969) and the Federal Budget Code (1969) which further specify the tasks of the BRH, and the *Bundesrechnungshof* Act (1985) which focuses on the structure and organisation of the BRH. The Standing Orders and Audit Rules of the BRH further reinforce the legal framework.

The BRH is free to determine the timing and nature of audit work and there are no restrictions on its audit activities. It should be noted that while the BRH is not required to act at the request of the government or the parliament, in practice it will respond to requests from the parliament. The BRH may also take into consideration petitions from citizens or issues reported in the media when selecting audit topics (BRH, 2009).

The appointment process for the President and Vice-President is as follows: they are proposed by the federal government, elected by the *Bundestag* and *Bundesrat* and then appointed by the Federal President for a twelve-year non-renewable term. Given that its status is at the level of a constitutional body, the BRH prepares its own budget request which is examined by the Parliament's Budget Committee and included in the Government's budget proposal without any changes.<sup>17</sup>

The BRH follows a board or collegiate model structure. As such, audit decisions are made unanimously by panels (or colleges) of BRH Members, typically at least two Members (i.e. the Senior Audit Director and the Audit Director) although the President or Vice-President may join to form a three member panel for audits for particular importance. If the panels are unable to reach a unanimous decision and in matters of special significance, the BRH may form a “Senate” comprised of the Head of Division, the heads of the audit sections, the head of another audit section outside of the division, and, if necessary, the Vice-President or the President. The governing board or “large Senate” of the BRH is responsible for highest-level decision-making involving issues that concern more than one audit division, including the annual report and special reports. The governing board takes decisions on a majority basis. It is comprised of the President, Vice-President, the Senior Audit Directors (heads of the nine audit divisions) and several Audit Directors (heads of the audit units).<sup>18</sup>

The audit units generally reflect the government departments they are responsible for auditing, although in some cases they may be organised around horizontal competencies such as personnel expenditure or IT so that findings in these areas are evaluated by means of uniform standards and principles (Garcia Crespo, 2005). Administrative tasks are performed by the Presidential Division.

#### **4.2.2. Role of the BRH throughout the budget cycle**

The core tasks of the BRH are promoting regularity, legal compliance and efficiency (value-for-money). The BRH does not, however, judge the merits of policy decisions. The BRH is also tasked with making recommendations on the basis of its audit findings and advising the bodies under audit and the parliament, often in advance of decisions on major projects or programmes. This advisory function highlights the importance placed on value-for-money and how the role of the BRH extends beyond the audit phase of the budget cycle.

During budget formulation, the BRH consults with the Federal Ministry of Finance and representatives of the BRH participate in meetings with the ministries on their budget bids. Given the recent reforms, as early as December/January, the BRH may inform the Federal Ministry of Finance and the line ministries about its previous findings in order to highlight potential issues at the level of line items. As such the BRH exerts a certain amount of influence on the March benchmarks figure. Subsequently, during the budget approval phase, the BRH provides advice to Budget Committee Rapporteurs and is represented during Rapporteur talks with line ministries. Representatives of the BRH also participate in all Budget Committee Meetings including the settlement session (see Section 6). During budget implementation, audit findings may lead to inefficient expenditures being cancelled.

All activities at the federal level that have a direct or indirect impact on the budget of the assets of the Federation are subject to audit. In particular, the BRH conducts audits on:

- all revenue and expenditure of the Federation, including special funds;
- public corporations established under federal law, such as institutes, agencies, foundations, corporations, and any federal enterprises taking this legal form;
- social security institutions established and controlled directly under federal or state laws, receiving grants from the Federal Government or where the Federation has entered into guarantee commitments; and
- the activities of the Federation in private law enterprises of which it is a shareholder (with an audit approach following commercial principles such as Telekom AG or Deutsche Bahn AG).

The BRH is not restricted from auditing sensitive activities related to defence or intelligence services but it must ensure compliance with legal provisions on data protection and on professional and official secrecy when treating classified information.

The main document produced each year by the BRH is the Annual Report. This report is submitted to both the government and the parliament, and presented in a public press conference by the BRH President in the fourth quarter (November/early December). Given that the BRH holds very few press conferences and that the BRH President tends to highlight major – and sometimes amusing or embarrassing – examples of inefficiencies, the press conference for the Annual Report generates substantial public interest.<sup>19</sup>

The Annual Report contains the BRH's most significant findings and recommendations and is used by the parliament to grant discharge to the Federal Government. Since 2009, as a supplement to the Annual Report, the BRH provides further audit findings to the parliament in spring, providing an updated basis for the discharge procedure. According to Section 97(2) of the Federal Budget Code: "The annual report shall state in particular:

1. Whether the amounts stated in the budget and capital accounts tally with the ledgers and whether audited receipts and payments are properly supported by vouchers.
2. In which significant instances the regulations, rules and principles of financial management have not been observed.
3. Which criticisms of substance have arisen from the audit of state participation in enterprises with independent legal status.
4. What action is recommended for the future."

The Federal Budget Code also specifies that the information in the annual report is not limited to the financial year – it may "include statements relating to subsequent or previous financial years" (Section 97(3)). This happens in practice, for example, the BRH provides information on trends in federal financial management. In this context the BRH analyses the medium term financial perspective of the federation and gives comment on its sustainability. Crucial aspects of this annual assessment are the development of the main expenditure categories (expenditure on social security, interest payment, staff, investment) and revenues (taxes), as well as the deficit with regard to compliance with national and European deficit rules. The findings on trends in federal financial management supplement the annual findings concerning the budget accounts and the assets and liabilities accounts, which are related to the past.

In addition, the BRH prepares around 900 audit notices on findings that were not considered significant enough to be included in the annual report. These are not submitted to parliament and are not public. The BRH also prepares around 50-60 reports each year at the request of parliament. Typically such requests would have to come from the Budget Committee as a whole. To enhance public outreach efforts in future, the BRH is considering whether to publish such reports as a matter of routine, once parliamentary deliberations are concluded. Finally, the BRH occasionally publishes special reports on large scale audits, for example recent reports on public procurement of construction services and prevention of corruption or on the reduced VAT rate and proposals for future development of tax reduction.

Given that ensuring efficiency or value-for-money is among the core tasks of the BRH and is of significant interest to parliament, the BRH increasingly focuses on performance and results. This focus is reinforced by the explicit advisory role of the BRH discussed

earlier and the tradition of giving the role of Federal Performance Commissioner to the President of the BRH (see Box 10 below). However, the BRH is often hampered by limited information within the line ministries in this regard. Indeed, one BRH study found that in around 85% of cases no efficiency control was carried out by the line ministries. Moreover, little exists in terms of performance related information, targets or objectives in the budget documentation.

#### Box 10. The Federal Performance Commissioner

Since 1952 the President of the BRH has traditionally served *ex officio* as the Federal Performance Commissioner. The Vice-President of the BRH acts as a deputy. The Commissioner does not have staff or a separate budget at his or her disposal and therefore largely relies on the findings and resources of the BRH.

The Commissioner is mandated to put forward proposals, recommendations, reports and opinions in order to enhance the efficiency of the federal administration (see Guidelines for the Federal Performance Commissioner of 26 August 1986 – BAnz No. 163, p. 12485). In addition, the Commissioner is involved in the preparation of federal legislation, ordinances and administrative regulations. In carrying out his or her duties, the Commissioner may advise the Federal Government, individual federal ministries or the parliament.

The advisory functions of the Commissioner and the BRH are mutually complementary. In theory, the Commissioner and the BRH may hold different views. In practice, however, this is unlikely to occur due to their highly co-operative relationship.

The second stage of the audit process is the political control by the parliamentary Audit Committee, a subcommittee of the Budget Committee of the *Bundestag*, culminating in the procedures for granting discharge to the government by the *Bundestag* and *Bundesrat*.

In the *Bundestag* the annual report is referred to the Budget Committee (BC) which in turn refers it to its Subcommittee on Audit for in depth deliberations. Similar to the budget approval procedure, ministers or high ranking ministry officials participate in the Subcommittee on Audit discussions along with officials from the MOF and the BRH. The BRH prepares a draft recommendation for each item and the Subcommittee can either endorse the BRH recommendations or simply acknowledge them. The Subcommittee may also expressly disapprove of specific matters under scrutiny (Art. 114(5) Federal Budget Code). Most decisions of the Subcommittee on Audit are taken unanimously, and the vast majority of the recommendations of the BRH are endorsed (upwards of 90%).

The executive is obliged to implement recommendations that are endorsed and, according to the Federal Budget Code 114(4), the “*Bundestag* shall determine a date on which the Federal Government shall report to the *Bundestag* and the *Bundesrat* on the measures that have been initiated.” This underscores the importance of the relationship between the BRH and the parliament as the BRH cannot on its own compel compliance with its recommendations. The BRH tracks all recommendations that are endorsed by parliament.

The Budget Committee also generally accepts recommendations of the Subcommittee on Audit and refers its report to the plenary for final debate and approval. The *Bundestag* and the *Bundesrat* decide independently of each other whether to grant discharge the Federal Government. In practice, discharge is always granted.

### 4.2.3. Conclusions on the Court of Audit

The BRH is a highly independent and well-respected institution with comprehensive powers. The strong link between audit and the other stages of the budget cycle is one of the strengths of the German budget system, as is the strong link between the BRH and the Parliament's Budget Committee and Subcommittee on Audit. However, given its mandate to promote efficiency, the BRH would benefit from access to more systematic performance information targets or objectives from line ministries, and in the budget documentation more broadly.

### 4.3. Long-term sustainability issues

The Federal Ministry of Finance periodically produces a *Report on the Sustainability of Public Finances* ("Sustainability Report"). Three Sustainability Reports have been produced between 2005 and 2011. The reports and the current update, whose underlying projections are carried out by external researchers, provide a clear and accessible overview of the evolution of the public finances over a long-term (50-year) horizon, taking compliance with the debt-brake fiscal rule in the near-term (4-year) horizon as a starting assumption. For the period after the 4-year horizon, which corresponds with the Financial Plan that accompanies the budget, it is assumed that the existing policies remain in place so that the underlying trend of expenditures and revenues – in the absence of budgetary policy action or structural economic reform – can be discerned.

The Sustainability Report takes a whole-of-government approach encompassing the *Länder*, municipalities and their social insurance schemes. The report takes a long-term approach in the broad sense – providing a context for the evolution of demographic drivers over the period since 1871, and of public debt since 1950.

As regards assumptions and scenarios for the analysis, the report adopts two base scenarios – optimistic (Variant T+) and pessimistic (Variant T-) according to the respective set of assumptions regarding long-term developments in demographics, the labour market and general economic growth. On the basis of these assumptions, the key result is a projection for the debt-to-GDP ratio (as a percentage of GDP) over the projection period. For the 2011 Sustainability Report, the result shows a sharp increase in the debt ratio from 83% in 2010 (the starting point) to 300% by 2060 under Variant T-, with a much more modest increase to just over 100% of GDP under Variant T+.

Given the wide disparity between these two results, it is particularly important to avoid confusion (or complacency) in the minds of policy-makers, particularly (but not exclusively) at the political level, and to focus upon operational policy messages. The report indeed attempts to do so by conducting a sensitivity analysis which decomposes the factors accounting for the difference between the T- and T+ variants. This analysis shows how changes to baseline assumptions affect the evolution of the debt ratio, and indicates that policies addressing some of these factors (e.g. net immigration and unemployment) could have a strong positive effect, whereas other factors (e.g. the fertility rate) do not have a strong bearing on sustainability at least over the projection period. Moreover, analysis of alternative scenarios and policy simulations relating to other policy areas – notably population health and the operation of the statutory long-term care insurance programme – also yield insights into the sustainability impact of these policy areas.

The issue of long-term sustainability of public finances is one which, in broad terms, has commanded the attention of Germany's most senior policy makers,<sup>20</sup> and it is likely

that analyses such as those provided in the Sustainability Report over the years have played a role in this development. The reports give a clear message about the impact of demographic and other factors and of the scale of policy action that is required over several parliaments (or “legislative periods” as they are referred to in Germany). On the other hand, the acknowledged importance of the topic is not matched by the attention that is accorded to the Sustainability Report and its findings; the document appears to be viewed as a worthy official study rather than a major fiscal reporting event such as the annual budget.

To address this shortcoming, and command greater engagement of policy-makers, the existing strengths in the report should be built upon. The risk of identifying “long-term” problems is that policy-makers may regard the solutions as something to be likewise addressed over the long-term, rather than factored into current budgetary plans. This risk is perhaps accentuated by explicitly assuming – as the report does – that the government’s medium-term plan will be adhered to, and confining itself to policy variants beyond that horizon. Through this approach, politicians and senior bureaucrats may be receiving an unintended signal that the policy messages contained in the report are not relevant for them, but for the generation of policy-makers who will succeed them. It is also notable that there is at present no requirement on line ministries, or on the government as a whole, to respond to the report or to devise strategies to close the sustainability gaps identified.

As regards the policy priorities themselves, there is scope to sharpen these and make them more relevant. The sensitivity analysis conducted by the Federal Ministry of Finance is useful for explaining the differences between the T+ and T- policy variants, and some policy messages may be inferred from these. However, it would be wrong to confine an analysis of long-term sustainability policy to the options emerging from such a technical analysis: there are undoubtedly a range of other policy factors which, while not relevant to the T+/T- distinction, would nevertheless impact significantly on long-term debt trends. The population health analysis, which is dealt with summarily in the report, is one good example of such a policy option; other options would arise in other social and economic areas. A Sustainability Report might have more direct impact as a tool of fiscal policy if it a) provided a more comprehensive – and perhaps politically uncomfortable – menu of policy options which would have a significant bearing upon long-term sustainability, and b) linked in to the Financial Plan, and thus to the budgeting process itself, in a more direct way.

One way of addressing these issues would be to present the Sustainability Report in the future not as a purely Federal Ministry of Finance publication, but as a whole of government publication in which line ministries are expected to present policy responses (as is already the case in the sustainability chapter of the annual Stability Programme), or at least policy options, that would have a bearing upon long-term sustainability. By presenting the Report at a suitable juncture in the annual budget process – for example in March (as the Federal Ministry of Finance did with the 2014 interim update), alongside the government’s technical Benchmark Decision, or shortly thereafter alongside the annual Stability Programme – the way could be opened for these policy messages to have an impact on the budget process itself before the draft budget is presented to parliament in August.

The option of conducting the long-term sustainability analysis alongside a periodic spending review process, and integrating the process within the mainstream of fiscal policy-making via that route, is discussed in Box 10 above.

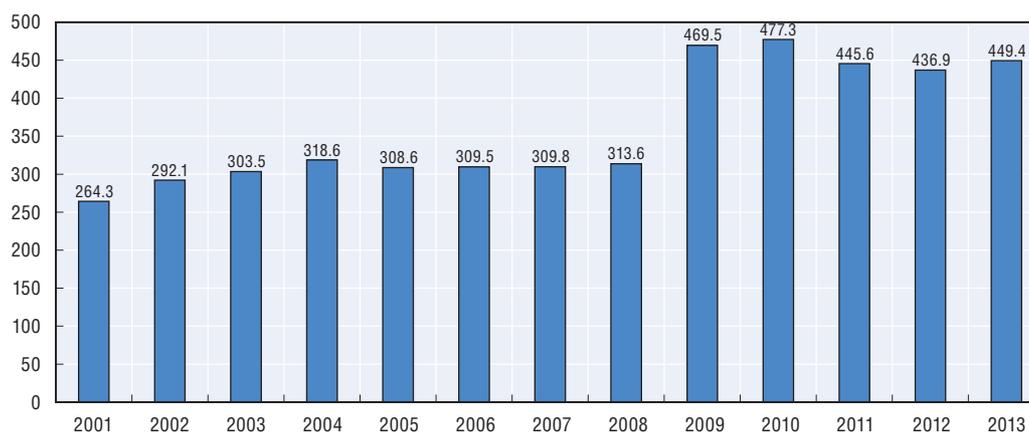
Separately, it should be noted that the MOF also produces a Subsidy Report which assesses the full extent and nature of the state’s support for various sectors.

#### 4.4. Consideration of fiscal risks

Beyond the specific topic of long-term sustainability, there are a range of mechanisms in place in Germany for factoring fiscal risks into the policy-making process, reflecting the heterogeneity of risks that arise from various sources. For example, Germany has a long tradition of supporting trade and economic development through the provision of guarantees and surety obligations to the private sector. Under Article 115(1) of the Basic Law, all such guarantees must be specified, quantified and authorised in a federal law. In practice, the federal Budget Act has been used as the vehicle for dealing with all such guarantees so that the amounts involved can be taken into account in the context of the overall budget calculations.

Over recent decades, however, the use of guarantee authorisations has expanded considerably in scope, in particular in response to the global financial crisis since 2008 (see Figure 3 below). Apart from the budget authorisations, additional guarantees may be given to address “unforeseen and compelling needs” subject to the prior consent of the Budget Committee of the *Bundestag*. Depending on the nature of the issue under consideration, it is open to the Budget Committee – and indeed to other parliamentary committees that examine matters relating to fiscal risk – to address these matters in private session.

Figure 3. Budget guarantee authorisations since 2001



Source: German Federal Ministry of Finance.

The *Finanzbericht* (detailed annual financial/budgetary report) provides an overview of the various guarantees and other contingent liabilities including, in recent times, euro stabilisation measures. As outlined in the next section, the future costs associated with capital projects and in particular Public-Private Partnerships (PPPs) feature also in the budget documentation. More generally, the range of economic risks and forecasting/estimation risks are addressed in the respective economic reports throughout the annual cycle. The Federal Court of Audit also plays a role in commenting upon estimation risks at particular stages of the budget process (see Section 4.2 above).

As is the case in many OECD countries, it is difficult to form a clear and comprehensive overview of the full range and extent of fiscal risks that arise for Germany as a whole – notwithstanding the useful detail that appears in various sources. As referenced in Section 2, for example, the monitoring and enforcement of sound fiscal planning within the *Länder* pose particular challenges and risks, which will be an important topic in the future

deliberations of the Stability Council and its independent advisory body. Germany's annual Stability Programme includes a section on fiscal risks in line with the standard format, and may provide a useful starting point for future comprehensive and transparent reporting on this subject.

## 5. Capital budgeting

### 5.1. Overview of capital budgeting process

As in most OECD countries the budgeting for capital projects are integrated into the ordinary budget process. Capital investment is identifiable in the budget, but it is treated as any other expenditure in the process rather than having a separate framework and process. Investment spending at the federal level mainly happens in the sectors of transport and defence and amounts to about 2% of the federal budget in 2014. Most capital investment activity takes place at the state or municipal level. Table 3 below illustrates the responsibilities with regards to capital investment.

Table 3. **Responsibilities regarding capital investment at different levels of government**

Federation	State	Municipal government
Armed forces	Supervision of local authorities	Water supply (households and businesses)
Diplomacy	Higher education	Waste disposal (households and businesses)
Postal service	Schools	
	Road building	
	Government buildings	

There are a number of infrastructure and network plans in Germany (see Box 11). These are co-ordinated at the federal level by the Federal Ministry of Finance, but more detailed co-ordination and planning efforts take place at the sectoral level, in particular with regards to transport. This is discussed further below.

#### Box 11. **Infrastructure and network plans in Germany**

- Federal Transport Infrastructure Plan
- Federal Regional Policy Plan
- Trans-European Transport Networks
- Energy Network
- EU-Habitats Directive
- 16 Länder-level plans, regional development plans & programmes, regional project plans
- Sector-specific plans such as energy plan or mining in North Rhine-Westphalia

Source: Federal Ministry of Finance.

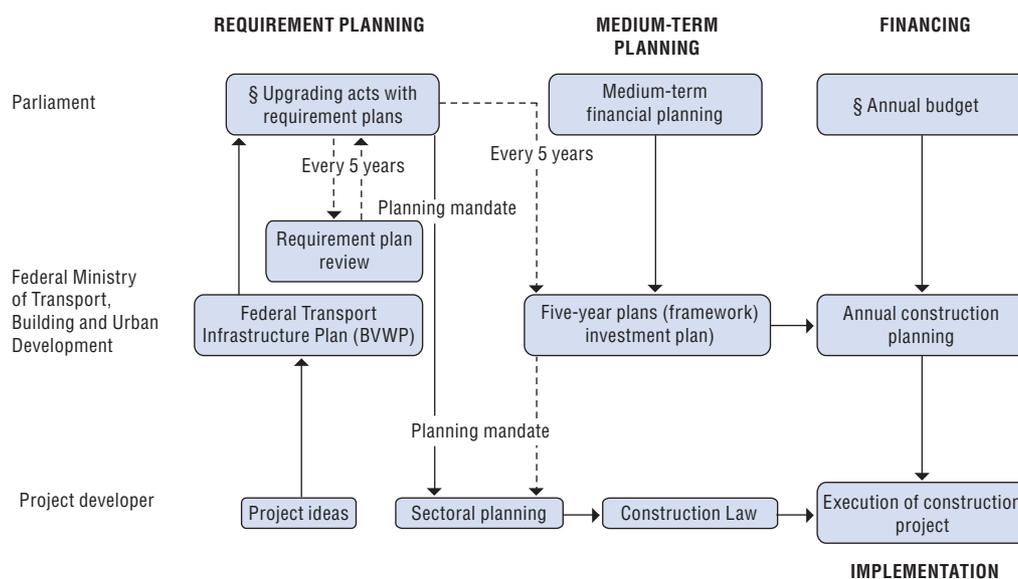
#### 5.1.1. Multiannual planning framework for transport

The Federal Ministry of Transport and Digital Infrastructure (Federal Ministry of Transport) had an investment budget of approximately EUR 10.7 billion in 2013 which reflects the level in recent years. The Federal Ministry of Transport uses a multiannual planning framework in the form of the federal transport infrastructure plan. The current

plan, endorsed by the government, covers the period 2003-15. In essence, the plan takes the form of a “long list” of projects that are evaluated according to cost/benefit analysis. The “long list” of projects is constructed on the basis of the ministry’s assessment of pressing economic infrastructure and regional development needs which in turn are informed by inputs from the political level, sub-national governments and other stakeholders.

The analysis of a particular project is based on a rather sophisticated methodology. Key components of the analysis include: reduced transportation costs, travel time, safety benefits, security, regional economic and social impact, job creation and derived economic effects. The methodology is made publicly available. If the result is positive (i.e. a benefit to cost ratio above one) the project is included in the plan. Projects are subsequently ranked according to their score, the expected need for the project and the assessed urgency in constructing the asset. Given the obvious links to the *Länders’* transport responsibilities, detailed agreements across levels of government have to be reached before the plan is adopted. This process of co-ordination ensures that the plan is realistic and supported. The federal transport infrastructure plan is then adopted by the federal government in the planning act. The next step is the amendment of the requirement plans (see Figure 4). The requirement plans are set in federal law (regarding federal roads and rail) and need to be approved by parliament.

Figure 4. **The capital planning process**



When the requirement plans have been passed, they are operationalised into the five year framework investment plan. This aligns with the medium-term financial planning framework and forms the basis for the budgeting for specific projects. However, the fact that an infrastructure project is accepted into the above mentioned plans does not mean that its financing is assured. Financing for a project is allocated as part of the ordinary budget process.

As discussed further in Section 1 above, line ministry requests for funding are resolved in negotiation between the respective line ministry and the Federal Ministry of Finance prior to the budget being submitted to parliament. Given the long lead times for capital

projects, a key role for the Federal Ministry of Finance is to ensure that the capital project portfolio fits into the long term capital budget envelope. The appropriation allocated in the budget is not for a single capital project. Rather, the appropriation mandates spending on a portfolio of capital projects within a relevant category (e.g. road or rail investment). Naturally the political level plays a key role in deciding which projects will be part of the portfolio appropriation. As in most countries, political support for a project can be more important than what technical cost/benefit estimates indicate. During budget execution the appropriation framework allows some possibility for the government to change and reallocate the funding within the portfolio. This has, however, been subject to intense debate as some members of parliament disapprove of the executive using such flexibility with regards to the allocation of appropriated funds.

In a typical project cycle in Germany, the Federal Ministry of Finance acts as the gatekeeper at key moments in the projects' progress towards completion. The Federal Ministry of Finance negotiates the budget for the planned projects of a given year with the relevant ministry. It checks the contracts of certain projects with regard to their soundness, realism and budgetary viability. The Federal Ministry of Finance will usually be part of the steering committee of projects and will thereby ensure that it can monitor the project as it moves from the project identification stage to the preparation stage, procurement stage and implementation stage. At the end of both the preparation stage and the procurement stage the Federal Ministry of Finance must give its approval for the project to move forward. At the same time the Federal Ministry of Finance notifies the Parliament's Budget Committee. For example, regarding transport infrastructure, the Federal Ministry of Finance negotiates the budget for the planned projects for a given year with the Federal Ministry of Transport. For the federal trunk roads, the projects are listed in the road construction plan (*Straßenbauplan*) and are attached to the federal budget as a supplement. Major projects in the sectors of rail and waterways are listed in the budget itself. This is to ensure, that public money is spent only for the listed projects. In addition, the Federal Ministry of Finance checks any important draft contracts in the railway sector which provide the legal basis for financial relations with the state owned rail company Deutsche Bahn AG. As noted above, contracts are checked with regard to their soundness, realism, and budgetary viability. In the case of construction of buildings etc. according to Section 24 of the federal budget code the Federal Ministry of Finance has to approve the necessary documents (see below) before expenditure is allocated in the budget. If these documents are not available during the preparation of the budget, the expenditure is blocked until they are presented to the Ministry of Finance, where a unit of architects and engineers is employed to check and approve them.

Section 24 of the federal budget code stipulates the documentation that has to accompany the project appropriation (Box 12). The documentation includes plans, cost calculations and qualitative explanations of the project as well as the proposed method of financing and the time table for the project. In addition, the project documentation must include an estimate of the required annual operational expenditure that is to be expected after the asset has been constructed. The appropriation is made on a commitment basis. Investments taking place using the Public-Private Partnership procurement model (PPP) are budgeted into the annual budget on the basis of the annual charge that has to be paid to the operator. The federal budget documentation contains an annex that gives an overview of all PPP projects and life cycle commitments of the federal government derived from the PPP contract.

### Box 12. Federal Budget Code

Section 24 – Construction measures, major procurements, major development projects

1) Expenditures and commitment appropriations for construction measures may not be budgeted until plans, cost calculations and explanations are available showing the type of work, the cost of the construction measures, of the land transfer and of the installations, as well as the proposed method of financing and a time schedule. An estimate of the annual burdens on the budget which will be incurred after completion of the measure shall be enclosed with these documents.

2) Expenditures and commitment appropriations for major procurements and development projects may not be budgeted until plans and estimates of the costs and cost sharing are available. Subsection 1), second sentence, above shall apply accordingly.

3) Exceptions to subsections 1) and 2) above shall only be permissible if, in an individual case, it is not possible to complete the documents on time and if the Federation would sustain any disadvantage from a postponement of budgeting. The need for an exception shall be substantiated in the explanatory notes. Expenditures and commitment appropriations relating to measures for which no documents are yet available shall be blocked.

4) Subsections 1) to 3) above shall be applied accordingly to separately budgeted expenditures and commitment appropriations relating to allocations if a total of more than 50 percent of the costs is covered by allocations from the Federation, *Länder* and municipalities. The Federal Ministry of Finance may permit exceptions.

The capital budgeting process in Germany provides a sound and transparent model for allocating and authorising resources, but as in many OECD countries the Federal Ministry of Finance is concerned with the observed difference between budgeted costs and actual costs of projects; and the time it takes for a project to move from the pre-feasibility phase to completion. One recent response has been to create a real estate agency as a new actor in the costing process, with the mandate to cost projects better. It is currently too early to say whether this initiative will have the desired effect. OECD evidence shows that PPPs are better with regards to the construction costs and timeliness of construction (Burger and Hawkesworth 2013). However, there is no evidence to judge whether PPPs in general outperform traditional infrastructure procurement (TIP) with respect to operation and whole of life costs. It would seem, however, that OECD countries employ various tools to mitigate some of the traditional shortfalls in the capital investment framework. For instance, many countries now use initiatives to counter optimism bias. Optimism bias is the tendency of capital budgets to underestimate significantly the construction costs and time of most capital projects.<sup>21</sup> These issues should not detract from the overall picture of a strong capital budgeting system in Germany. It is characterised by a systematic, clear and coherent process that incorporates planning, a traditional cost-benefit assessment framework and a strong link to the budget process in the short and medium term.

## 5.2. Public-Private Partnerships in Germany

### 5.2.1. Use of PPPs

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.

### 5.2.2. 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 co-operation 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 (as set out in Section 7 of the Federal Budget Code). The guidelines set out a multi-stage process (Figure 5) in which the most cost-efficient solution for delivering the asset is estimated. The process is characterised 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.

Figure 5. **Stages of PPP economic feasibility analysis**

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

The line ministry at the federal level implements the various steps of the project and notifies the 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.

### 5.2.3. Institutional framework

The Federal Ministry of Finance is the main body for setting and co-ordinating PPP policy across the Government. It is responsible for PPP strategy, the legal framework and federal and international co-operation. 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.

### Box 13. PPP-Policy Unit in the Budget Division, Tasks

- Development of core PPP policy issues in Germany
- Budgetary project auditing for departmental budget divisions
- Supervision of Partnership Germany
- Mandates on PPP groundwork assignments
- Deal with international aspects of PPP (e.g. input on PPP in international organisations, PPP development partnership with foreign countries, bi-national PPP projects, foreign PPP projects for domestic contractors).

Partnerships Germany (*Partnerschaften Deutschland-ÖPP Deutschland AG*) was established in January 2009 and replaced the Federal Public-Private Partnership Steering Committee and its Task Force. The decision reflected a need for a stronger PPP capacity in government (OECD, 2010). Partnerships Germany's mandate is to enhance PPP delivery; provide neutral consulting services; combine public and private sector knowledge and maximise the efficiency gains for the public sector. It works at both the federal, *Länder* and municipal level. It provides project specific advisory services and general knowledge and framework analysis. The former is primarily focused on line ministries, *Länder* and municipalities, the latter on the Ministry of Finance. The project advisory services range from the provision of specific technical input at any stage to full project management of the preparation, tendering and implementation process. The general knowledge work includes the development of the legal and institutional framework and standards, knowledge transfer between all actors involved in public-private partnerships and identification of priority areas for government attention. Partnership Germany consists of about 30 staff and is funded solely on a fee-for-service basis. The employees are on private sector contracts.

#### 5.2.4. Sub-national PPP Units

A number of *Länder* have also established their own dedicated PPP units to support government organisations to procure and manage public-private partnerships projects. Beginning with North-Rhine Westphalia which created a PPP Task Force in 2001, many other *Länder* followed in 2004 and 2005. The structures and competencies of these centres are very heterogeneous, raising calls by the federal government for a more homogeneous approach. A number of *Länder* have not established dedicated PPP units to date. A federal PPP network (*Föderales PPP Netzwerk*) exists between the federal government, *Länder* and municipalities help to facilitate reciprocal knowledge transfers vertically between different levels of government and horizontally between *Länder*. The implementation of the recommendations that are worked out in this way occurs on a voluntary basis.

#### 5.2.5. Legal framework

The PPP Acceleration Act (2005) sets the general legal, financial and technical framework for public-private partnership in Germany. The act is a framework law which partly transposed EU procurement directive 2004/18 into German national law. The Act came into force in September 2005 and led to changes in a number of German laws – including those for procurement, tax, public road fees, budget and investment – to eliminate impediments related to PPPs. A number of policy goals were also outlined in the explanatory statement for the Act, including the provision of central guidance through manuals and standardised

Table 4. PPP units in Germany (OECD, 2010)

Level of government	Year established	Unit(s)	Under the authority of	Sectors	Level of Government	Steering Committee
Federation	2008	ÖPP Deutschland AG	Federal Ministry of Finance	Construction	F, FS, M	No
	2008	Transport Infrastructure Financing Corporation	Federal Ministry of Transport, Building and Urban Development	Transport	F	No
Baden-Württemberg	2004	PPP Task Force	FS Ministry of Economy	Construction <sup>1</sup>	FS <sup>1</sup>	Yes <sup>1</sup>
Bavaria	2004	PPP Working Group	Supreme Building Authority ; FS Ministry of Home Affairs	Construction and Transport	FS, M	Yes <sup>2</sup>
Berlin			Finance Administration	Construction and Transport	FS, M	No
Brandenburg	2004	Department	FS Ministry of Finance	Construction and Transport	FS	No
Bremen	2004	Department	Senator for Environment, Construction, Transport and Europe	Construction and Transport	FS, M	No
Hamburg	2004	Department	Finance Authority	Construction and Transport	FS, M	No
Hessen	2005	PPP Centre of Excellence	FS Ministry of Finance	Construction and Transport	FS (Building); M (Consulting)	Yes <sup>3</sup>
	2008	Department	FS Ministry for Transport, Building and Regional Development	Construction and Transport	FS	No
Rhineland-Palatinate	2001	PPP Competence Network	FS Ministry of Finance	Construction and Transport	FS, M	Yes <sup>4</sup>
Saarland	2001	Department	FS Ministry of Economy and Employment	Construction and Transport	FS, M	No
Saxony	2001	Department	Saxon State Ministry of Finance	Construction and Transport	FS, M	No
Saxony-Anhalt	2005	PPP Task force	FS Ministry of Finance	Construction and Transport	FS, M	No
Schleswig-Holstein	2004	PPP Team	FS Ministry of Finance	Construction and Transport	FS, M	No
Thuringia	2004	PPP Working Group	FS Ministry of Construction and Transport	Construction and Transport	FS, M	No

F = Federal, FS = Federal State; M = Municipal.

1. Baden-Württemberg: Transport projects are the responsibility of the FS Ministry of Home Affairs; state projects are the responsibility of the FS Ministry of Finance; Steering committee established in November 2004.
2. Bavaria: Steering committee includes representation from Building Authority, FS Ministry of Finance, FS Ministry of Economy, FS Ministry of Home Affairs, municipal associations, association of building industry, audit institutions.
3. Hessen: Advisory Board, Group "PPP in Hessen".
4. Rhineland-Palatinate: Working group established in December 2005.

contracts and the establishment of centres of excellence. German procurement law is based on European procurement directives. To support the development of public-private partnerships, a number of guidelines have been developed by federal ministries and *Länder* since the 2005 PPP Acceleration Act. These cover the legal framework for PPPs, project assessments and contract relationship management (see Box 14).

#### Box 14. Supporting guidelines for public-private partnerships in Germany

- *A Guide to Efficiency Analysis for PPP Projects (2006)* sets a minimum standard for conducting efficiency analysis of public-private partnership projects by ministries and local governments in all sectors. The guide was prepared by the conference of federal state finance ministers, in close co-operation with the federal government.
- *PPP Good Practice Guide: Guidelines for Public-Private Partnerships (2008)* contains insights into the know-how and practical experiences of professionals in public sector construction

#### Box 14. **Supporting guidelines for public-private partnerships in Germany** (cont.)

and members of the federal public-private partnerships expertise network. The guide was prepared by the Federal Ministry of Transport, Building and Urban Development together with the German Savings Bank Association and the central organisations representing local government.

- *Guide to PPP and Legislation Governing Support (2006)* is a user oriented guide commissioned by the former federal PPP Task Force to determine whether or not planned projects are eligible as a public-private partnership.
- *Study on PPP for Schools, with Procedural Guides and Model Contracts (2008)* is a guide designed to facilitate the implementation of public-private partnership projects within the education sector. The study was commissioned by the PPP Task Force of the Federal Ministry of Transport, Building and Urban Development.
- In 2008 *Partnership Germany* was established. Federation and *Länder* identified the need for groundwork to develop PPP in Germany and mandate Partnership Germany with it. The Groundwork of Partnership Germany took the place of the former publication activities concerning guidelines, best practice and similar information. Published to date in “ÖPP Schriftenreihe” ([www.partnerschaften-deutschland.de](http://www.partnerschaften-deutschland.de)) are 14 works (2 in progress) for example:
  - ❖ PPP and lighting projects (Volume 2)
  - ❖ PPP and mid-sized companies (Volume 6)
  - ❖ Remuneration- and controlling systems with PPP projects (Volume 14)

This also includes the development of a spreadsheet tool to assist users to conduct an economic feasibility analysis.

While some regulatory obstacles to PPP have been removed, some sector specific issues still remain. For instance, some municipal public funding laws on roads, hospitals and schools differentiate between the investment for construction and the maintenance and operation costs. This system is not compatible with the PPP life-cycle approach. Integrated water PPPs, including fresh water supply and wastewater treatment are rarely implemented because of the differences in the applicable VAT rates (OECD 2010).

#### 5.2.6. **Conclusions**

Capital budgeting in Germany is managed well, and the use of PPP procurement 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. PPP procurement of infrastructure is rightly perceived as a method for procuring capital assets that should only be used when it represents increased value for money compared to the traditional infrastructure procurement method, 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.

## 6. Budget approval and oversight

### 6.1. The German parliament

Germany is a federal parliamentary republic with federal legislative power vested in two bodies, the *Bundestag* or Federal Diet and the *Bundesrat* or Federal Council.<sup>22</sup> Coalition governments are common on both the federal and state levels and the *Bundestag* and the *Bundesrat* often have differing political majorities.

The *Bundestag* is comprised of around 630 members elected through a mixed voting system with about half directly elected (majority or first-pass-the-post) and half elected from parties' state lists (proportional). Members serve four year terms although the *Bundestag* can be dissolved earlier by the President if the Chancellor loses a vote of confidence.

The *Bundesrat* represents the sixteen *Länder* (federal states). Its 69 members are not elected; rather delegations are appointed by the *Länder* governments and members' terms are linked to those of the *Länder* governments. One of the particularities of the *Bundesrat* is that each delegation must vote *en bloc*. Each state is allocated at least three votes, and a maximum of six, which are allocated based on a form of degressive proportionality according to population size.

Although the budget is submitted to both legislative bodies simultaneously, the *Bundestag* has the prerogative in the budget process.<sup>23</sup>

#### Box 15. The German Bundestag and the European Union

European policy is increasingly merging with domestic policy in Germany. The Eurozone crisis in particular has impacted heavily on the on the legislative work of the Bundestag, its organisation and agenda, and the parliamentary administration. In recent years, the Bundestag has sought to strengthen its rights to scrutinize and participate in government policymaking as regards European policy, have been strengthened through revisions to the Act on Co-operation between the Federal Government and the German Bundestag in Matters concerning the European Union (EUZBBG) and the Responsibility for Integration Act (IntVG). In 2007 the Bundestag opened a liaison office in Brussels tasked with monitoring forthcoming initiatives and decisions at the European level, and with improving networking and dialogue. Its personnel are provided by the parliamentary administration and the parliamentary groups.

In January 2013, the parliamentary administration in Berlin also established a new European affairs sub-directorate, including a new analytical division responsible for assisting Members and parliamentary groups in areas covered by the Economic Affairs Committee, the Finance Committee, the Budget Committee and the EU Affairs Committee. The secretariat of the Committee on the Affairs of the European Union (established when the Maastricht Treaty was ratified) was incorporated into this new directorate. The Budget Committee acquired a new role in decisions on the European Financial Stability Facility and the European Stability Mechanism. It has seen its workload increase dramatically and has been forced to take on more of a law-making function than previously (Schattenmann, 2013). As part of its response to these increasing demands, the Budget Committee has maintained its own Subcommittee on European Union Questions with around 12 members since 2002 (see below).

### 6.2. The Budget Committee

The Budget Committee (BC) is regarded as the *Bundestag*'s most powerful and prestigious committee. Traditionally, it is the largest of the permanent committees with just over

40 members assigned to it based on proportional representation of the party groups in the *Bundestag*.<sup>24</sup> The prominence enjoyed by the Budget Committee is further enhanced by the important role played by its two subcommittees: (1) the Subcommittee on Audit<sup>25</sup> with around 15 members and the newer Subcommittee on European Union Questions with around 12 members (see above).<sup>26</sup>

By tradition, the chair of the Budget Committee is always a member of the largest opposition parliamentary group. This is in line with what is considered good practice in many parliaments (e.g. UK and the majority of Westminster style parliaments, France) and signals a willingness to operate the committee in a nonpartisan and consensual manner. Most of the Budget Committee's meetings are held in private. This is seen as a way to further depoliticise the committee's work. However, the committee publishes the results of its deliberations, and hearings are held in public. In contrast to the work of the BC, party divisions are on display during budget debates in the plenary which is always public.<sup>27</sup>

The Budget Committee organises its work through a strict rapporteur system. At the beginning of each electoral term the Budget Committee appoints a lead rapporteur and three assistant rapporteurs (one from each party) to cover each departmental budget. The rapporteurs remain responsible for this portfolio for the full electoral term (or more, especially in the case of rapporteurs from smaller parties), allowing them to develop significant expertise. Again, the responsibility of the rapporteurs is considerable because in addition to their work within the Budget Committee, they are the principal source of information for their parliamentary groups and their advice generally forms the basis of their parliamentary group's evaluation of the departmental budget in question (Linn and Sobolewski, 2010). The BC's Subcommittee on Audit also uses a rapporteur system but only one member is assigned as rapporteur per portfolio and there are no assistant rapporteurs. A rapporteur of the subcommittee cannot serve as a rapporteur for the same ministry or department in the Budget Committee.

#### Box 16. The Bundesrat Finance Committee

The Finance Committee of the Bundesrat has main responsibility for review of the federal budget in that chamber. It is comprised of 16 members who are typically the Finance Ministers in their home states. Unlike in the *Bundestag* where tax legislation is dealt with separately in the Finance Committee, the Bundesrat's Finance Committee combines both roles.

### 6.3. Staffing and analytical support

The Budget Committee and its subcommittees are supported by a Secretariat of around 10 staff. Their tasks are mainly administrative in nature – drafting letters and replies to inquiries, providing logistical support for committee meetings (agenda, speakers, papers, minutes, etc.), preparing and accompanying parliamentary delegations, and writing up committee recommendations and detailed reports for the plenary. The BC Secretariat occasionally contributes to the work of the *Bundestag* Research Services Budget and Finance Division (the *Wissenschaftlicher Dienst* or WD4). This division of around five nonpartisan staff mainly responds to requests from the Budget and Finance Committees, although its work tends to focus on legal, political, and historical matters. Due to the impact of the Eurozone crisis on the workload of the *Bundestag* and the BC in particular, the parliamentary

administration reorganised some of its staff and hired additional staff for a new European Affairs sub-directorate, including a small liaison office in Brussels. Party groups also have a support staff, a limited number of whom may be specialised on budget issues.

As noted in Section 4.2, parliament receives substantial support from the *Bundesrechnungshof*. Parliament may also consult with outside experts in the Council of Economic Experts or the various research institutes but in practice such consultations are *ad hoc* rather than systematic and tend to be focussed on new projects.

The limited amount of designated in-house specialist support available to the BC highlights the capacity imbalance between the executive and the parliament, particularly given the level of detailed scrutiny undertaken by the BC. In practice, parliament depends on the executive for information and analysis and makes full use of its right to request it. At times the burden on ministry staff is high. Given the nature of Germany's parliamentary government and the respect commanded by the *Bundestag* and the BC, information is usually forthcoming but parliament's capacity to break it down and independently verify it remains limited.

In 2012, in the context of discussions and proposals on implementation of the Fiscal Treaty and the new Stability and Growth Pact, the Social Democrats (SPD), at that time the largest opposition party, proposed the creation of a "National Council for Budget and Fiscal Policy" – in essence a sort of hybrid of the fiscal council model chosen by many EU countries and a parliamentary budget office (PBO).<sup>28</sup> In the end, however, rather than create a new PBO or enlarge the mandate of an existing independent body, parliament adopted the government's proposal to establish an "independent advisory council" to assist the Stability Council in monitoring compliance with the upper limit for the structural general-government deficit under Section 51 Subsection (2) of the Budgetary Principles Act. This new body alongside other independent inputs into the forecasting process is seen as meeting the new EU requirements (see Section 4.1), but does little to increase the analytical capacity of the parliament. Although the SPD proposal failed to gain sufficient support within parliament at the time – in part because of resource concerns – the issue of establishing a parliamentary budget office may be reconsidered in a subsequent legislative term. Such an office could be beneficial if it could provide advice in real time or from a forward looking perspective, in contrast to the advice provided by the BRH. There are other arguments to be made in favour of a PBO. The BC also scrutinises any legislation that will have a budgetary impact (e.g. additional expenditure or decreases in revenue). As such, independent policy costings or the less resource intensive option of independent verification of costings – functions that could be carried out by a PBO – would no doubt be useful.<sup>29</sup>

The growth of specialised bodies to assist the legislature in budgetary matters is a strong trend in OECD countries. Such bodies serve to rebalance the asymmetry of information between the executive and the parliament and have the potential to improve transparency and to enhance the credibility of the government's budget and the public finances. In addition to evaluation of fiscal policy and budget proposals, common functions include a role in economic or budgetary forecasts, monitoring compliance with fiscal rules, assessing medium or long-term fiscal sustainability, a role in policy costings; and other analytical studies. These bodies are quite diverse. For example, they may take the form of specialised units within parliamentary research services, parliamentary departments with independent mandates, or fully independent institutions. Examples of the former include the Scrutiny Unit in the United Kingdom parliament, the Budgetary

Control Department in the Research and Information Center in the Israeli Knesset, and the Department of Social and Economic Research in the Bureau of Research in the Chancellery of the Polish *Sejm*. Australia, Austria, and Canada have all set up Parliamentary Budget Offices (PBO), and Italy is in the process of establishing a PBO which will meet the new EU regulations on independent bodies. The largest independent bodies are the Korean National Assembly Budget Office (NABO) and the Congressional Budget Office (CBO), with 125 and 250 staff respectively but the Canadian Parliamentary Budget Office performs similar functions (sometimes on a smaller scale) with just 15 staff and a budget of CAD 2.8 million, the equivalent of less than EUR 2 million.

#### 6.4. Parliamentary approval and oversight of the budget

The parliament has no formal role in budget preparation. Informally, the parliamentary groups and Members may signal their priorities or give opinions. During the first half of the year, Budget Committee (BC) rapporteurs often conduct on-site visits and are in regular contact with officials in the ministries that they cover and with relevant sectoral officials in the MOF.<sup>30</sup> In addition, every Member has the right to submit questions and every parliamentary group has the right to submit bundles of questions (*Anfragen*) should they wish to obtain specific information about the government's budgetary intentions. The government does not produce a pre-budget report and the legislature does not hold a pre-budget debate. One of the results of the top-down budgeting reforms however is that the parliament receives information earlier in the budgetary process with the March key figures decision. Prior to the introduction of the top-down budgeting reform, the first information parliament received came in July following Cabinet's approval of the draft budget. The benchmarks decisions are discussed in the BC but the legislature is not involved in setting the budget ceilings required by the new top-down budgeting reform. This differs from the practice, for example, in Sweden where the parliament debates the government's Spring Fiscal Policy Bill and approves the aggregate level of expenditures and revenues, essentially ensuring the legislature's commitment to the ceilings before they review the budget.<sup>31</sup>

Table 5. **Parliamentary budget approval timetable**

August	Budget submitted to <i>Bundestag</i> and <i>Bundesrat</i>
September	First reading in <i>Bundestag</i> and <i>Bundesrat</i> ; start of Rapporteur discussions and Budget Committee deliberations
October	Update to macroeconomic forecast (medium term)
November	Budget Committee settlement session. Update to tax revenue estimate (medium term); Second/third reading in <i>Bundestag</i> and approval of budget; approved budget sent to <i>Bundesrat</i>
December	Second reading and agreement in <i>Bundesrat</i> ; promulgation in Federal Law Gazette

The parliament comes to the fore during the budget approval phase. In line with OECD best practices for budget transparency,<sup>32</sup> the draft budget (Budget Act and budget proper<sup>33</sup>) is submitted to the *Bundestag* and the *Bundesrat* simultaneously, around four months prior to the start of the fiscal year, usually in late August and no later than “the first week of the *Bundestag*'s session following 1 September”.<sup>34</sup> This allows adequate time for meaningful legislative review. Along with the draft budget, the government submits a Financial Plan (or medium-term budget strategy covering 5 years) and a Finance Report.<sup>35</sup> The budget presented to parliament has upwards of 6 000 line items so parliamentary scrutiny happens at a very detailed – and some would argue an unnecessarily detailed – level. Parliament has nevertheless resisted attempts at reforms that would have reduced the number of line

items arguing that this would diminish parliamentary influence and control, as well as expressing other concerns about accrual accounting adding complexity (see Section 3.2).

The *Bundesrat* has six weeks to prepare its comments and suggestions on the budget for the *Bundestag*. The Federal Ministry of Finance may draft a response to the comments of the *Bundesrat* which is approved by cabinet before being sent to the *Bundestag*. The *Bundestag* may choose to accept or ignore the advice of the *Bundesrat*.

The Budget Committee rapporteurs familiarise themselves with the draft budget figures even before the draft budget is officially presented in parliament. The BC rapporteurs also co-ordinate with, and provide important inputs to, their parliamentary groups' budget working groups which meet to prepare and co-ordinate party positions on the budget. To ensure executive-legislative co-ordination, officials usually join the working group sessions of the party in power or the ruling coalition. This gives members of the ruling coalition a certain informational advantage over the opposition.

The *Bundestag* holds three readings. At the first reading in September, the Federal Minister of Finance presents the budget. After several days of debate in the plenary, the budget is referred to the Budget Committee for more in-depth deliberations. Although legally referred to the Budget Committees, the sectoral committees also review the sections of the budget relevant to their portfolios. During this period the BC rapporteurs engage in extensive consultations with the ministries and departments under their responsibility. Consultations are kicked off by full day meetings between BC rapporteurs and ministry officials during which the rapporteurs go through the ministries spending plans line by line, asking questions and making suggestions. Representatives from the MOF and the BRH also attend and provide advice. The latter helps ensure that the relevant audit findings are continuously fed into the budgetary process and the BRH is often quite effective in getting their advice taken on board. As the rapporteurs continue their review, they engage in an on-going dialogue with the ministries asking extensive follow-up questions and giving opinions on potential changes.

The sectoral committees provide feedback or make proposals to the BC but the BC has the ultimate decision-making power as to whether or not to include these proposals.<sup>36</sup> In a sense, the relationship of the Budget Committee vis-à-vis the sectoral committees mirrors that of the Finance Ministry vis-à-vis the line ministries, with the BC viewed as the guardian of fiscal discipline. The majority of parliaments in OECD countries have opted for a review process characterised by a dominant budget committee responsible for overall budget review that co-ordinates varying levels of input from sectoral committees. Ideally a strong budget committee promotes co-ordination and consistency in legislative budget action and facilitates fiscal discipline, while involving sectoral committees allows the legislature to draw on their specific expertise when reviewing departmental spending plans (Posner and Park, 2007; Schick, 2002). In the *Bundestag*, the BC's rapporteur system ensures that even without the input of the sectoral committees, the BC has access to and develops significant expertise on departmental budgets.

The BC rapporteurs present their reports and proposed amendments in a standard format for discussion and agreement by the full BC. These sessions are attended by the minister or high-level officials from the relevant spending ministry, and officials from the Budget Division of the MOF and the BRH. If the minister or ministry officials are not appropriately prepared to defend disputed expenditure, or should they fail to attend, they face a serious risk of cuts or the application of qualified freeze. The BC accepts the vast

majority of the rapporteurs' recommendations. More controversial items are revisited and decided upon in a final "settlement" session which can run through the night. Again ministers, the MOF and the BRH are represented. The MOF prepares a substantial set of mainly technical recommendations for this session.

If they are not completely satisfied, the BC has a unique power to insert a "qualified freeze", either on a specific item or on a percentage of that item. In essence this means that appropriated funds cannot be spent without further authorisation from the BC. Although infrequent, a qualified freeze tends to be used either where a ministry has failed to fully convince the BC, in connection with controversial capital expenditure projects, or if the BC wants additional say on which individual projects should be funded. The latter serves as a sort of "fine-tuning" instrument, for example, the BC could authorise spending on monuments with a qualified freeze allowing them greater say later on which specific monuments should be funded. Some have argued that this power can be interpreted as blurring the line between legislative approval and executive implementation (Wehner, 2001).

The Budget Committee presents its final consensus report with its proposed amendments to the plenary for the second and third readings sometime in November. These amendments are typically adopted with little or no changes. The *Bundestag* has unrestricted amendment powers which it does not hesitate to use in practice. During the second reading each departmental budget is voted on. During the third reading, the entire budget with amendments is put to a final vote before being sent back to the *Bundesrat* for a second reading and agreement. If the *Bundesrat* has serious reservations it may, within three weeks, ask that the Mediation Committee be convened (Art. 77 of the Basic Law). This body which brings together an equal number of Members from the *Bundestag* and the *Bundesrat* may then propose amendments that must be voted on in the *Bundestag*. If the proposed amendments are rejected by a majority of the *Bundestag* the *Bundesrat* may again lodge an objection within two weeks but the *Bundestag* can override this objection and pass the budget. In practice, the *Bundesrat* rarely objects.

The budget is passed in December before the start of the fiscal year, although delays are typical in election years.<sup>37</sup> After its passage through the legislature, the budget becomes law when it has been countersigned by the Finance Minister and Federal Chancellor, signed by the Federal President, and promulgated in the Federal Law Gazette. The executive does not have the power to veto a budget approved by the legislature but should changes to the draft budget have a significant impact in terms of increasing expenditure or decreasing revenues, the executive may demand further legislative deliberations (Art. 113 of the Basic Law). During budget execution, the executive may also spend less than what has been approved by the legislature – e.g. they have the authority to spend but not the obligation to spend what has been approved.

Should the legislature fail to pass the budget before the start of the fiscal year, Article 111 (1) of the Basic Law allows for all necessary expenditures to be made:

- to maintain institutions established by a law and to carry out measures authorised by a law;
- to meet the legal obligations of the Federation;
- to continue construction projects, procurements, and the provision of other benefits or services, or to continue to make grants for these purposes, to the extent that amounts have already been appropriated in the budget of a previous year.

If specific revenues and working capital reserves are insufficient to cover these expenditures, Article 111 (2) of the Basic Law allows government to borrow up to a maximum of one quarter of the total amount of the previous budget. Moreover, Section 5 of the Federal Budget code allows the Federal Ministry of Finance to issue general administrative regulations concerning provisional budgetary and financial management.

Although parliament takes a back seat during budget implementation, it maintains strong oversight through, for example, monthly expenditure reports (which are given to the parliament and published and include information on the federal budget, the Stability Programme, and the *Länder*) and quarterly reports on debt management. In addition, as part of the procedure for granting the prior consent of the Finance Ministry, the *Bundestag* and the *Bundesrat* are notified of any excess or extra budgetary expenditure every three months and in more extreme cases immediately. The BC rapporteurs can at any time request additional information and updates. The BC can also request that the BRH monitors and assesses the execution and progress of particular projects and the BRH reports answering upwards of 900 parliamentary questions in a typical year.

As noted earlier, if a qualified freeze is in place, more information must be provided to the BC before they authorise money to be released. Line ministries cannot negotiate with the BC directly on the qualified freeze. Rather they must first convince the MOF which then makes the request to the BC.

The parliament comes to the fore again during the audit phase when it examines the annual report of the BRH (see Section 4.2 for a full discussion). The Federal Ministry of Finance also renders accounts to the *Bundestag* and the *Bundesrat* of all revenues and expenditures, as well as of assets and debts (Article 114 (1) of the Basic Law).

### 6.5. The impact of the legislature

The *Bundestag* has unrestricted powers to amend the draft budget which it does not hesitate to use in practice making around several hundred amendments every year (Wehner, 2001). However, the *Bundestag* is also bound by a constitutional requirement (Art. 110 (1) of the Basic Law) that the budget shall be balanced with respect to revenues and expenditures and ostensibly by the new “debt brake rule”. Ordinarily, if the BC decides to significantly increase spending in one area they are in contact with the MOF for advice on other areas with savings potential. In addition, a large portion of the budget is taken up by mandatory spending, effectively limiting room for manoeuvre.

In practice, while the *Bundestag* is highly influential in the budget process it has consistently demonstrated a preference for fiscal prudence. The majority of amendments tend to be fairly small and to involve reallocation of funds. The Budget Committee often tries to achieve higher savings and to reduce the deficit in accordance with new tax revenue estimates. This however does not mean that constituency needs are not prioritised, as demonstrated by a recent decision by the BC to provide an additional EUR 1.75 billion for road construction, beyond what had been recommended by the Federal Ministry of Finance.

Table 6. **Bundestag amendments to the budget adopted in 2009-13**

Fiscal year	2009	2010	2011	2012	2013
Number of amendments adopted	1 053	1 142	1 080	919	947

Source: Secretariat of the Budget Committee of the *Bundestag*.

Table 7. **Impact of parliamentary amendments – Budget Committee deliberations (thousand €)**

Fiscal year	2012	2013	2014
Increase in revenues	7 000 820	4 619 100	2 504 098
Reduction of revenues	-5 691 240	-4 570 302	-4 704 538
Increase in expenditure	898 033	292 742	895 215
Reduction in expenditure	-1 847 382	-813 118	-2 633 714
Resulting change in total revenues	1 309 580	48 798	-2 200 440
Resulting change in total expenditure	-949 349	-520 376	-1 738 499

Source: Federal Ministry of Finance.

Table 8. **Impact of parliamentary amendments – Budget Committee settlement session (thousand €)**

Fiscal year	2012	2013	2014
Increase in revenues	142 420	1 622	208 440
Reduction of revenues	-1 252 000	-250 420	-8 000
Increase in expenditure	1 990 667	2 008 023	512 749
Reduction in expenditure	-841 318	-1 687 647	-774 250
Resulting change in total revenues	-1 109 580	-248 798	200 440
Resulting change in total expenditure	1 149 349	320 376	-261 501

Source: Federal Ministry of Finance.

## 6.6. Conclusions on the role of parliament

**The German parliament enjoys a reputation as one of the most influential and fiscally prudent legislatures as regards the budget process.** The *Bundestag*'s role is enhanced by the Budget Committee's system of rapporteurs shadowing particular line ministries, the integration of the approval and audit functions, the powers of the Budget Committee and the *Bundestag* to amend the draft budget, and the special power to insert a "qualified freeze". These powers ensure a genuine democratic control of the public finances.

**However, the focus on micro-level management of budgetary allocations could be better balanced with higher-level accountability** on the objectives and impacts of expenditure policy. In particular:

- 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 for each area of spending.
- While parliamentarians enjoy good access to detailed information from the MOF and the BRH, there is a certain imbalance of analytical capacity at the disposal of parliament in making higher-level independent assessments of the executive's budgetary policy and its impacts. Some mechanisms for addressing this imbalance could be explored, taking account of Germany's established institutions and cultural norms. Parliament could revisit the option of an independent Parliamentary Budget Office, or enhance existing analytical resources/staffing capacity within the parliamentary administration. Other options might include a re-configuration of existing independent institutions (or of their mandates) so that they are more directly at the disposal of parliament in addressing broader questions of budgetary policy. Such initiatives would also enhance the ability of

opposition parliamentarians to scrutinise overall budget policies and objectives: at present, government deputies enjoy easier (although by no means exclusive) access to official channels.<sup>38</sup>

### 6.7. Citizen engagement

The process of shaping the budget draws together contributions from many sources, including from citizens themselves. The OECD endorses civic engagement as a strategy to promote good government practices, close the gap between the government and citizens, improve citizens' trust, and reduce their cynicism towards government (Tanaka, 2009).

At the federal level, citizen engagement in the budget process (and more broadly) remains limited, with public officials often uncertain of its potential and usefulness (EIPP, 2009). Initiatives are focused on providing information on the budget process and raising citizen awareness. The Federal Ministry of Finance has extensive online resources available to citizens including a special website that allows citizens to download the annual budget documents, supplementary budgets, and underlying data, and to explore aspects of the federal budget through interactive data visualisations ([www.bundeshaushalt-info.de/startseite/](http://www.bundeshaushalt-info.de/startseite/)).

By contrast, a wave of innovative approaches can be found at the municipal level. In its 6th Annual status report (2013) the online portal [www.Buergerhaushalt.org](http://www.Buergerhaushalt.org),<sup>39</sup> noted that there are 247 municipalities either considering or with experience of some form of participatory budgeting. The vast majority of these exercises take the form of online consultations but some include mailings, phone surveys and public meetings. They may have the express goal of obtaining citizen input on cost saving measures (e.g. the "Solingen Saves"<sup>40</sup> initiative). Although sometimes criticised as expensive, with low participation levels or too focused on middle-class participants, vulnerable to capture by lobby groups, and in the case of savings measures as politicians "abdicating their responsibilities" to citizens, these "experimental" local initiatives may raise both administrators and citizens' expectations for broader engagement in future.

## 7. 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 is 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:

- the rule will need to be enforced rigorously during all stages of the economic cycle;
- 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 co-ordinating 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 is accepted by budgetary participants, although line ministries note that sector-specific policies, which could be raised and prioritised 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 co-ordination 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 (see xi(a) below).

**iv) The medium term dimension of budgeting is strong;** with the move to top-down budgeting, the multi-year aspects of budgeting – exemplified in the Financial Plan which traditionally accompanies the draft budget – have become more effective in setting the parameters for the subsequent budgeting cycles. In particular, the annual “benchmark decision” 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 analysed 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 be more clearly signalled 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 (see xi (e) below).

**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 is 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 maximised.

**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:

- 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.
- 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 scrutinise 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 (see also xii below).

**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 prioritisation 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-prioritisation 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 be clearly signalled 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 prioritising within their spending ceilings, and bringing forward evidence-based options for re-allocating 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 co-ordinate 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 co-ordinate with the Federal Chancellery in securing government buy-in for this approach.

**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 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.

## Notes

1. The Federal Ministry of Economics & Energy was constituted as such in late 2013; its predecessor was the Federal Ministry of Economics and Technology. This Ministry will generally be referred to as the Federal Ministry of Economics for convenience in this Report.
2. The federal budget contains approximately 6 600 line items, of which about 5 500 are expenditure-related; and of these in turn, about 3 000 may be subject to virement.
3. The new EU economic governance rules, which build upon the pre-existing EU Treaty provisions and the Stability & Growth Pact, are set out formally in a series of five Regulations and one Directive adopted in 2011 (the “six pack”) and two further regulations adopted in 2013 of primary relevance to euro-area countries (the “two pack”). Further related commitments are set out in other instruments and agreements, notably the inter-governmental Fiscal Compact Treaty which entered into force in 2013 and is currently applicable to 25 of the 28 EU countries.
4. See A. Lübke, “Fiscal Discipline between levels of Government in Germany”, *OECD Journal on Budgeting*, Vol. 5 No. 2 (2005).
5. The officials servicing the Council, who include officials from the municipalities and the Bundesbank as well as from the federal and Länder levels, meet on a more regular basis, at least three times a year.
6. In 2006, the Constitutional Court disallowed federal assistance to Berlin, in part because it did not consider that Berlin had taken sufficient measures of its own to address its budgetary difficulties.
7. The Coalition Agreement for the current German government was agreed between the political parties in late November 2013 after five weeks of negotiations.
8. For example, new policy priorities arose in Germany in recent years in the areas of sustainable energy policy and a subsidy for home childcare; both of these new priorities involved the identification of offsetting savings elsewhere.
9. Marine Portal, Rowan Jones and Klaus Lüder (2012) “French Revolution and German circumspection: reforming budgeting and accounting in national governments’ *Public Money and Management*, 32:5 357-361.
10. Appointments are staggered and each year, the term of one Council member expires. Council members cannot hold political posts concurrently and must not belong to any trade association or association of employers or employees/trade union, either currently or in the year before their nomination.
11. Estimated as 20% of their time although this can be difficult to define.
12. Although not an explicit goal, a by-product of the JEF is that it provides valuable funding for participating institutes and promotes economic research that might not otherwise be prioritized.
13. German Cities Council.
14. The Institute for the World Economy at the University of Kiel (IfW); Halle Institute for Economic Research (IWH); RWI Essen; German Institute for Economic Research (DIW) Berlin; and Ifo Institute – Leibniz Institute for Economic Research at the University of Munich.
15. It should be noted that the Court of Auditors and the Constitutional Court also have a role in monitoring compliance with fiscal rules.
16. The BRH is headquartered in Bonn and supported by seven regional audit offices in Berlin, Frankfurt am Main, Hamburg, Hanover, Coblenz, Munich and Stuttgart. The headquarters and regional offices comprise around 1 300 staff. Separately, the Länder have their own courts of audit guaranteed under the state constitutions. There are naturally many points of contact between the Federal Court of Audit and the Land courts of audit and if an audit is the responsibility of both the Federal Court of Audit and a Land court of audit a joint audit, they might undertake a joint audit.

The Conference of the presidents of the Federal Court of Audit and the Land courts of audit (Konferenz der Präsidentinnen und Präsidenten der Rechnungshöfe des Bundes und der Länder) meets twice a year to co-ordinate.

17. If the Federal Government's draft budget deviates from the BRH budget request without the consent of the BRH, then the parts for which no agreement was reached must be attached unchanged to the draft budget (Section 29(3) of the Federal Budget Code).
18. At the time of this review there were 49 audit units.
19. For example, in 2012 the President of the BRH called out the German Army for wasting millions of euros of taxpayers' money producing its own sunscreen, cough drops and lip balm rather than buying them off the shelf.
20. For example, the Federal Chancellor launched a National Strategy on Demography in 2011, and two demographic summits have been held since then.
21. Flyvbjerg, B., M.S. Holm and S. Buhl (2002), "Underestimating costs in public works projects: Error or lie?", *Journal of the American Planning Association*, 68(3), pp. 279-295.
22. While they are sometimes referred to as the lower and upper house, they are technically separate bodies and do not form a bicameral parliament.
23. The consent of the Bundesrat is required for legislation on tax revenues accruing wholly or in part to the Länder.
24. Unusually, following the federal elections in 2013, the new committee on economy and energy was the largest committee with 46 members.
25. Sometimes referred to as the Subcommittee on the Public Accounts.
26. There are four other parliamentary bodies with special tasks that are composed of members of the Budget Committee:
  1. The Confidential Committee set up under Section 10a (2) of the Federal Budget Code is responsible for discussion and decisions on the intelligence services' budgetary plans;
  2. A committee established under Section 3 (1) of the Act on Federal Debt Management (Federal Finance Panel) receives regular information from the Federal Ministry of Finance on all issues relating to federal debt and on all matters of fundamental policy and issues of particular importance relating to the Federation's holdings in companies under private law and the administration of these holdings.
  3. A committee established under Section 10a of the Financial-Market Stabilisation Act monitors the EUR 480 million federal banking bailout of autumn 2008. The panel deals with all issues concerning this fund and deliberates on long-term developments in policy relating to the financial market. (Linn and Sobolewski, 2010)
  4. A Special Committee for Eurozone Crisis Legislation was established under the 2011 Act Amending the Euro Stabilisation Mechanism to reach in special cases quick or confidential decisions on the release of funds from the euro bailout mechanism (the European Financial Stability Facility – EFSF), without a vote before the full parliament. This was successfully challenged before the Federal Constitutional Court and the role of the committee was subsequently amended under Section 6 of the 2012 Act on Financial Participation in the European Stability Mechanism. This allows for the Panel, drawn from members of the Budget Committee) to convene if the government invokes particular confidentiality when planning to purchase government bonds on the secondary market.
27. Traditionally members of the sectoral committees speak more in the first reading, while members of the budget committee intervene more in the second and third readings.
28. A former Director of the United States Congressional Budget Office and the Chair of the United Kingdom Office for Budget Responsibility were invited to give evidence at a budget committee hearing which can be viewed here <http://dbtg.tv/cvid/2021948>.
29. It should be noted that the legislature can draw on the work of the National Regulatory Control Council ("Normenkontrollrat" or NKRK), and independent advisory body, to assess compliance costs or the administrative burdens that new legislative proposals place on citizens, businesses and public authorities. Since 2011, the mandate of the NKRK was expanded to include review of regulatory proposals from the floor of the Bundestag. In May 2013, the Alliance 90/The Greens parliamentary group was the first parliamentary group to request that the NKRK to review a Draft Law on the Creation of a Register of Untrustworthy Companies (KorrRegG) (NKRK Annual Report, 2013).

30. The Budget Committee Rapporteurs may receive advance information on the budget and line items in their portfolios from the line ministries, although this is not a formal part of the budget process.
31. Interestingly the number and size of parliamentary amendments to the budget have decreased since the Riksdag began voting on ceilings (Wehner, 2011).
32. The “OECD Best Practices for Budget Transparency” (OECD, 2002) state that the executive’s draft budget should be submitted far enough in advance for proper review by the legislature – at least three months prior to the start of the fiscal year.
33. The budget proper includes the aggregate budget and the 22 departmental budgets. The aggregate budget includes a budgetary summary, calculations on the permissible borrowing under constitutional law, the financial balance (financing summary), and a borrowing plan. The departmental budgets are divided into chapters categorised according to each line ministry’s programmatic priorities and the subordinate authorities assigned to that ministry.
34. Federal Budget Code Section 30. See also Art. 110 (03) of the Basic Law.
35. Section 31 of the Federal Budget Code defines the Finance Report as, “a report on the current state of the public finances and their probably development in relation to the overall economic trend.”
36. The BC leadership may also co-ordinate with the leadership of the Finance Committee which is responsible for matters relating to tax legislation.
37. For a discussion of past trends, see Wehner, 2001, pp. 60.
38. It should be noted that Budget Committee members also have recourse to the so-called “Infobitte” (information request). Every member of the Budget Committee has the right to put questions to the Federal Ministry of Finance, unrestricted in number and size. The Federal Ministry of Finance will answer with a written report, usually very promptly. The answer is sent not only to the questioner, but to representatives of all political groups in the Budget Committee. Yearly requests number in the 100s.
39. Developed by civil society organisations on behalf of the Federal Agency for Civic Education (Bbp) and the Federal Ministry for Economic Co-operation and Development.
40. See [www.solingen-spart.de/](http://www.solingen-spart.de/), developed by the city of Solingen in partnership with ZebraLog and the Fraunhofer Institute IAIS (St. Augustine), with an online platform designed by Ontopica and Die Projektoren. In its first year (2010) the consultation resulted in a proposal to save EUR 44 million. Another interesting example is the City of Cologne which seeks proposals from citizens on expenditure, cost saving measures and revenues over a four week period each year via the online platform <https://buergerhaushalt.stadt-koeln.de/2013>. The platform also allows citizens to comment on and rate proposals. The ten most highly rated proposals are then reviewed by the administration, and forwarded to the Cologne city council along with a statement. The Council publishes a final accountability report with its decisions on the online platform.

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