Public debt - the example of Baden-Wurttemberg

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Summary

The indebtedness of public corporations in the Federal Republic of Germany has assumed dramatic proportions. At the end of 2005, the Federation, the federate states ("Länder") and the municipalities were in debt to the tune of €1.521 billion. Net lending/borrowing stood at 3.3% and aggregate debt was 68% of gross domestic product.

Indebtedness is threatening to render public budgets unviable. External public sector financial control in Germany is reacting to this development by continuing to tackle the subject, even in the public arena. The Courts of Audit report annually on increasing indebtedness and the long-term consequences which threaten to arise from it. With the aim of encouraging a turnaround in the trend, the President's Conference of the (German) Courts of Audit has repeatedly alluded to the problems publicly in joint statements and has put forward proposals for concrete measures. The most recent joint statement of May 2004 [1] attracted a good deal of attention in parliaments and the media. However, the approach to debt of the Federation and the "Länder" has essentially not altered.

The various regulations at EU, federal and "Land" level aim to keep public debt within as narrow limits as possible. In Germany constitutional law focuses on the investments in what concerns the Federation and "Länder": new debt is only allowed to the same amount as investments are made. EU law puts public debt in relation to the gross domestic product of the member state using the European Stability and Growth Pact, and provides for sanctions in the event of the regulations being breached.

In German public policy, the constitutional framework has proved itself to be too broad and unsuitable for debt containment. If, in spite of this broad interpretation, unconstitutional budgets have been drawn up - at both federal and "Land" level - they

[1] the Hildesheim statement of 07.05.2004, Internet: http://www.lrh.niedersachsen.de/PM/pm2004_02.htm

have been justified on the grounds that they serve to protect against a macroeconomic imbalance.

The European Stability and Growth Pact of 1997 and before that, the Maastricht criteria, have passed their initial practical tests. As a result of the period of stagnation at the beginning of this decade, the effect of these instruments has waned. Germany, which has now breached the EU criteria for four years in a row and exceeded the threshold of new debt set at 3% of GDP, is the prime culprit, and there is likely to be a further breach in 2006. In addition, the new interpretation introduced in 2005 of the criteria weakens the position of the EU in the face of escalating national debt.

As far as complying with these criteria is concerned, German public policy does not make any distinction of responsibility between the Federation and the "Länder". The division proposed in 2002 by the Financial Planning Council, whereby 55% of the potential debt is allocated to the "Länder" and municipalities, and 45% to the Federation and social security organisations, is too vague, and thus far it has not been possible to implement it. At present, the debts of the "Länder" and municipalities are also being attributed to the Federal Republic by the EU. However, the Federation would still have to deal with EU sanctions more or less on its own. The division of responsibilities and, where relevant, the costs, should be effected with the new financial arrangements between the Federation and "Länder" in the wake of the reform of the federal system.

In Baden-Wurttemberg, the Court of Audit has for a long time been calling for a move away from the policy of "easy, fresh money" through new debt. On numerous occasions it has asked the government and the parliament of the "Land", to actively implement the oft-repeated budgetary policy objective of attaining budgets without net borrowings. The governments of the "Länder" have announced objectives in accordance with this for budget years 1985, 2006 and most recently for budget year 2011. In point of fact, the Free State of Bavaria was the only federate state able to implement this objective for budget year 2006.

In the current annual report for 2006[2], the Baden-Wurttemberg Court of Audit will be proposing a new approach to the parliament and government of the "Land" which should heavily restrict by law the opportunities to accrue new debt. In essence, only those investments which are designed to serve the "Land's" own investments may be financed by new loans. Since to a large extent, the "Land" finances the investments of third

[2] Publication scheduled for July 2006

parties (e.g. the municipalities) and thus far has treated them as its own investments, a restriction of this type will drastically curtail opportunities to accrue debt. This would cause the scope for debt to fall to below a third compared with before. The discussion about this proposal is still ongoing.

In 2006 new elections were held in Baden-Wurttemberg. As a result of the current negotiations which are underway on the formation of a new "Land" government, plans have been announced to incorporate in law the objective of attaining net borrowing-free budgets from 2011. The Court of Audit's proposal is able to support this objective.