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Germany: the budget crisis has been resolved

Sebastian Płóciennik

It took almost a month for Germany's ruling coalition to decide on how to adjust the country's financial plans for 2024 to the ruling passed by the Federal Constitutional Court (FCC). In this ruling, the justices challenged the transfer in the 2021 budget of €60 bn from the fund to combat the COVID-19 crisis which had remained unused to the Climate and Transformation Fund (KTF) (see '*Germany: the Constitutional Court deprives the government of €60 billion earmarked for transformation*'). The Court ruled that the government's activities in this respect equated to a bypass of the constitutional debt brake.

The government's declaration that it does not plan to impose a 'state of emergency' in 2024, which could have enabled it to suspend the debt brake, is the key element of the compromise which has put an end to the political crisis triggered by the FCC's ruling. This means that next year's budget must observe the previously planned €16.6 bn limit as regards net debt. However, the ruling coalition has created two emergency exits for itself. As regards the first one, it has announced that it would investigate whether extraordinary spending could be necessary for the reconstruction of the Ahr valley, which suffered from extreme flooding back in 2021; this would require the suspension of the debt brake. The other potential emergency situation involves the need to increase assistance to Ukraine, especially should "other countries reduce their support".

Generally, the commitment to respect the debt brake means that a reduction in budgetary spending will be unavoidable. The KTF will be slashed by €12 bn in 2024 and by a total of €45 bn by 2027. However, this does not mean that the goals adopted for the KTF will be abandoned. For example, the funding for modernising railway infrastructure will be found from the profits earned from the sale of a portion of the stake which the state holds in companies such as Deutsche Telekom and Deutsche Post. In addition, the fund will still have around €160 bn at its disposal for 2024–7.

The cuts will also cover mechanisms referred to as 'climate-damaging subsidies' (€3 bn). These effectively involve, for example, the cancellations of the excise duty exemption for aviation fuel used in domestic transport and the tax relief for diesel used by farmers. Social spending cuts to the tune of €1.5 bn have also been announced. These will include the introduction of restrictions regarding unemployed people who evade taking up a job, the decision to cancel the training allowance offered to recipients of the citizen's allowance known as the *Bürgergeld*, and the plan to increase the effectiveness of job centres. Spending cuts will also affect German climate policy. The government will accelerate the process of withdrawing subsidies for the purchase of electric cars and reduce the scale of support offered to the photovoltaic industry. It has also had to abandon its plan to offer €5.5 bn in

subsidies for the operation of the electricity grid in 2024. Without these subsidies, in 2024 the transmission fee borne by electricity consumers will double (from 3.12 to 6.43 euro cents/kWh).

In its financial plan, the government has envisaged not only savings but also new sources of revenue. It has announced an increase in the CO_2 levy collected in the national emissions trading system from sectors such as transport and utilisation of buildings from the present €30 to €45 per tonne of CO_2 starting from 2024 (the initial plan was to raise this fee to €40). However, the ruling coalition argues that this does not equate to a toughening of the policy, but is rather a return to the system of fee increases introduced by Angela Merkel's government.

The agreement reached by the coalition has enabled the launch of the budget adoption procedure. Although the schedule of the Bundestag and Bundesrat sessions does not envisage any such vote before the end of this year, it is likely that the Bundestag's budget committee will make the relevant decisions before the Christmas break. If this is the case, both houses of parliament could vote on their respective resolutions in January. Until that time, the government will operate on the basis of a provisional budget.

Commentary

- Breaking the political deadlock which emerged following the announcement of the FCC's ruling was an issue of crucial importance for the SPD–Green–FDP coalition. The budget crisis has undermined the already low level of support for the government and its leaders . Chancellor Olaf Scholz in particular has come under criticism from the electorate, as according to the most recent DeutschlandTrend poll his present approval rating is just 20%. If the crisis had continued with the government proving unable to resolve it, the prospect of early elections would have become realistic. The agreement reached by the coalition has enabled it to take new measures and to focus the public's attention on its flagship initiatives, such as the law on economic opportunities (*Wachstumschancengesetz*) which is expected to help Germany to combat recession. In addition, the successful resolution of the budget crisis has boosted the government's position at the EU level ahead of the European Council meeting, during which issues such as the fiscal rule reform will be discussed.
- The agreement reached by the coalition envisages that the Climate and Transformation Fund will continue to be an important financial vehicle for spending on a comprehensive energy transition in the coming years. The spending cuts which will reduce the KTF's budget will omit several initiatives which are of major importance from the point of view of German industry, and which involve the plan to increase the carbon neutrality of industrial processes (for example in the metallurgical sector), to switch to hydrogen technology and to use other sources of heat. The government has also stuck to its decisions to reduce the price of electricity for companies starting from 2024. This involves a major reduction of the electricity excise duty (from €20.5 to €0.5/MWh) and the decision to prolong and expand the scope of compensation for the indirect cost of CO_2 emissions offered to energy-intensive industrial sectors. The government has also decided to maintain the planned subsidies for the construction of semiconductor manufacturing plants (including in particular the investment projects being carried out by

Intel in Magdeburg and TSMC in Dresden). However, the decision to cancel the subsidy for the purchase of electric cars sooner than initially planned will likely spark controversy in the automotive sector.

- From the point of view of Berlin's international commitments, the pledge to continue to offer assistance to Kyiv is of key importance. Chancellor Scholz has announced his intention to earmark €8 bn for arms deliveries and €6 bn for helping the refugees in the 2024 budget. Another issue of major political importance involved the declaration that due to the situation in Ukraine Germany is ready to suspend the debt brake in 2024. The minister for economic affairs Robert Habeck has stressed that "Putin should correctly interpret" this signal. However, it seems that this message was also targeted at the US administration, which has been unable to adopt a new assistance package for Ukraine for several months now.

- The agreement has seemingly put an end to the debate on reform of the debt brake (see ' *The consequences of the Constitutional Court's ruling. Ways out of the German fiscal crisis* '). However, the government has highlighted two potential situations in which the debt brake could be suspended and spending increased by an extraordinary procedure, which means that various concepts for reforming this restrictive regulation will still be present in the public debate. There are many indications that the absence of time-related pressure may create opportunities for a consensus to be found between the government and the CDU/CSU regarding the decision to establish a special budget earmarked for energy transition and infrastructural investment (some experts suggest that it should have up to €500 bn at its disposal). It could be modelled on the Bundeswehr assistance fund, which was established in 2023 and is enshrined in the constitution.