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Exceptional support for aggregate demand and for the financial sector has been inescapable for Germany in response to the crisis: from the end of 2008 to the beginning of 2009, the German government implemented discretionary fiscal policy measures up to almost €100 billion, with the effect mostly in 2009 and 2010. The German rescue scheme for the financial sector amounts to €480 billion. Since recovery remains fragile, it is not yet time to withdraw support. Further fiscal stimulus therefore will be provided by the Growth Acceleration Law effective as of January 2010.

These measures contributed to a stabilization of the real economy: quarterly growth rates of GDP have been positive since the second quarter of 2009. A severe weakening of the budgetary position, however, is the other side of the coin. Without any consolidation measures in the near future, this leads to a large deterioration of long-term sustainability gaps. The situation, which is similar in many other countries in the European Union (EU), also creates a great challenge for the European Stability and Growth Pact. From 2011 on, therefore, fiscal consolidation must and will be the top policy priority of German fiscal policy. While withdrawing financial policy support should not put financial stability at risk, a timely exit is important to minimize fiscal risks and to avoid costs that distort competition.

The need for fiscal rules in this situation and a firm commitment to them seem to be a necessary requirement for a credible exit. Germany is committed to fiscal exit strategies at two levels. On the European level, principles developed by the Economic and Financial Affairs Council (ECOFIN) of the Council of the European Union were endorsed by the European Council with a starting date for fiscal exit in 2011 at the latest. For Germany, the deadline for the correction of the excessive deficit is in 2013, with a minimum annual improvement in the structural balance of at least 0.5 percent of GDP.

The new constitutional budget rule constitutes the framework for the fiscal exit strategy on the national level with an overall limitation of structural deficits (federation: 0.35 percent of GDP; states: zero percent of GDP) while allowing automatic stabilizers to work. This rule will come into effect in 2011 with transitional periods—where structural deficits have to be reduced to the aforementioned levels—for the federal level until 2016 and for the states until 2020. The institutional framework is also strengthened by the fact that borrowing via additional funds to cover special financing needs—which was possible according to the old budget rule—will be justified only as an exception to the new rule from 2011 on.

Exit from support to the financial sector in Germany will be realized by a bottom-up approach that allows for a gradual phasing out. A combination of procedural rules and

incentives is ensuring a timely exit that responds flexibly to individual needs. By law, the German rescue scheme expires at the end of 2010. It is approved by the EU Commission on a six-month basis under state aid rules; an obligation for renotification ensures that an exit will not be inappropriately delayed.

Exit from individual stabilization measures (guarantees, recapitalization, and impaired asset relief) will be taken once viability of the individual bank is ensured. Guarantees (currently €127 billion) are limited to a maximum of five years and will phase out automatically at maturity. Banks that receive a recapitalization under the German rescue scheme (recapitalizations so far: €22 billion) have to present a restructuring plan under state aid rules. State aid rules provide for an automatic exit. They strike a balance between competitive functioning of the financial market and the need to stabilize the financial system. The possibility of creating bad banks allows the liquidation of impaired assets (to date, €6 billion), while the remaining core bank has to prove its viability and follow a restructuring plan.

The support measures to the financial sector have also increased requirements for fiscal policy analysis and management. Most of the financial market support measures have not yet had an impact on public deficits, but they increased the level of gross debt markedly. Supplementary tables published by Eurostat in the context of the Maastricht notification provisions create a certain degree of additional fiscal transparency with respect to all interventions at the EU level, though comparability across EU member states might not be perfect.

Government has to be careful in designing the exit path—not too early and not too late, differentiating between supporting the financial markets and the economy as a whole. Putting aside gross economic error or obvious political misjudgment, the risks from “too late” are, in my opinion, much more serious than those from “too early,” hampering market expectations and the structural reform agenda with a huge impact on sustainability and potential growth in the long run.