EUROPEAN
COMMISSION

Brussels, 22.2.2017
C(2017) 1201 final

ANNEX 9

ANNEX

Country annex

GERMANY

to the

REPORT FROM THE COMMISSION

presented under Article 8 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

GERMANY

Germany deposited its instruments of ratification of the Treaty on Stability, Coordination and Governance in Economic and Monetary Union (TSCG) with the General Secretariat of the Council of the European Union on 27 September 2012.

National provisions considered in the assessment are essentially those provided for by:

- the Basic Law (in particular Article 109, Article 109a, Article 115 and Article 143d),
- the Act on the Implementation of Article 115 of the Basic Law,
- the Fiscal Compact Implementation Act adopted on 15 July 2013, amending the Budgetary Principles Act and the Stability Council Act, and the rules of procedure (*Geschäftsordnung*) of the Stability Council.

1. Legal status of the provisions

The provisions enshrined in the Basic Law, which are of constitutional rank, are quite detailed. The Basic Law sets out a balanced budget rule for the Federation and the states (*Länder*), and specifically details the rule and a debt brake system for the Federation. The *Länder* have competence over the details of their rules, within the parameters laid down in the Basic Law. Other provisions contained in ordinary laws come as a complement to guarantee compliance with the structural balanced-budget rule at general government level (*Haushaltsgrundsätzegesetz*) and to provide for an independent monitoring authority (*Stabilitätsratsgesetz*).

Against that background, taken together Germany's provisions comply with the criterion of being of "binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes".

2. Balanced budget rule

Formulation: The balanced budget rule is implemented via the Constitution and via an ordinary law.

At the constitutional level, Article 109 of the Basic Law requires, as a rule, the federal budget and the budgets of the *Länder* to be balanced. That rule is deemed to be fulfilled for the federal budget if the net borrowing does not exceed 0.35% of GDP, with the obligation to take into account the effect of the cycle (Article 115 of the Basic Law). For the *Länder*, the rule is deemed respected if the budget is balanced, with the possibility to take into account the effects of the cycle. The *Länder* can specify the details for this rule according to their competences. The German authorities explained that the rules stemming from Article 109 of the Basic Law also bind the budgets of the social security funds and the local authorities, as these are under the responsibility of, respectively, the Federation and the *Länder*. That explanation confirms that the coverage of the Basic Law corresponds to the general government sector. Additionally, in an ordinary law, the Budgetary Principles Act (Section 51, subsection 2) as amended on 15 July 2013 sets a lower limit for the general government structural balance of - 0.5% of GDP. While the Basic Law sets an ad-hoc numerical limit for the balance of the general government, the Budgetary Principles Act ensures that the lower limit for the structural balance is in line with the most stringent lower limit set in the TSCG.

In terms of the specifics of the formulation of the targets, the Basic Law only sets numerical limits without explicitly referring to the medium-term objective (MTO) as defined in Regulation (EC) No 1466/97. However, as confirmed by the German authorities to the Commission, some of the national provisions are specifically designed to promote adherence to the MTO. First, the statement of legislative intent accompanying the draft of the 2009 constitutional amendment makes the link between the balanced budget requirement for the budgets of the Federation and the *Länder* and the "*close to balance or in surplus*" requirement of Regulation (EC) No 1466/97. Second, the statement of legislative intent accompanying the amendment to the Budgetary Principles Act states that the aim of Section 51, subsection 2, is to implement the first sentence of Article 3(2) of the TSCG and ensure compliance with the MTO on a sustained basis. Third, the Budgetary Principles Act refers to the Stability and Growth Pact (SGP) and the TSCG for "*details of the definition of, calculation of and permissible deviations from the upper limit, as well as the scope and time frame for reducing the general government structural deficit in the event of a deviation*".

Convergence towards the MTO: Germany has adequately converged to the MTO in conformity with the national provisions. Potential deviations from the MTO are catered for by the correction mechanism.

Escape clauses: Article 109 of the Basic Law provides that an exception to the constitutional balanced budget rule can be made in the event of natural catastrophes or specific emergencies beyond the control of the government with significant negative impact on public finances. While "natural catastrophes" are not explicitly part of the SGP definition of exceptional circumstances, they can be covered by the notion of "unusual events" referred to in the SGP. The borrowing limit can then be exceeded on the basis of a decision by a majority of the Bundestag's members and the decision has to be linked to an amortisation plan. Moreover, Section 51, subsection (2), of the Budgetary Principles Act explicitly refers to Article 3 of the TSCG and the SGP when it comes to determine permissible deviations, including the ones stemming from "exceptional circumstances".

Overall, the balanced budget rule complies with the TSCG requirements. While the rule anchored at the constitutional level sets nationally designed numerical targets for the general government, other national provisions ensure that the rule effectively complies with TSCG requirements. The escape clauses are consistent with the TSCG.

3. The correction mechanism

The provisions relating to the correction mechanism derive from the balanced budget rule itself, complemented by a debt-brake system, in particular for the Federation (Article 115, Act on the implementation of Article 115).

Activation: The obligation to adopt annual budgets that respect the balanced budget rule creates an in-built correction mechanism. Indeed, the provisions imply that in the event of an observed deviation, a structurally balanced budget must be restored as soon as the following year. In consequence, the legislation requires automatically the presentation and adoption of budgets consistent with the structural balanced budget rule, irrespective of possible deviations in previous years. This applies to the budgets of both the Federation and the *Länder*.

In addition, Article 115 of the Basic Law and the Act on the implementation of Article 115 put in place a control account in regard to the Federation. The control account records deviations from the structural deficit ceiling in budget execution and cumulates them over time. A negative balance of the control account exceeding 1.5% of GDP requires corrective action. The implementing provisions set out in ordinary legislation reduce the threshold to 1%

of GDP. Some *Länder* have adopted comparable systems. There is no such system for the general government sector as a whole.

Substance of the correction: The balanced-budget rule implies taking corrective action that re-establishes a structurally balanced budget within one year following a possible deviation. By construction this captures the notions of proportionality and MTO adherence encapsulated in the common principles. The reference to the Commission's method for evaluating structural balances facilitates consistency with the EU framework.

Moreover, in the event of breaching the threshold for the control account, subsequent budgetary targets at the federal level are revised upwards by up to 0.35% of GDP in the following year in order to recoup the cumulated debt slippage. That provision is mandatory only during upturns, in order to avoid pro-cyclicality.

The Stability Council, with the support of the Independent Advisory Board, monitors compliance with the balanced-budget rule twice a year. If the general government deficit ceiling is projected to be exceeded, the Stability Council issues recommendations for corrective measures to the respective governments and parliaments of both the Federation and the *Länder*.

The Basic Law also includes provisions for allocating across the Federation and the *Länder* the sanctions imposed on Germany in the case of non-compliance with the SGP. The Federation bears responsibility for the developments of social security funds, and the *Länder* for their municipalities.

Overall: The correction mechanism is compliant with the TSCG requirements and the common principles. The legislation implies a binding ex ante structural balanced-budget rule, which as such constitutes an automatic correction mechanism in the event of deviations, with no basis for flexibility even in the event of large deviations. The system is complemented by a debt brake mechanism based on control accounts which, at least at the federal level, provides a safeguard against cumulated deviations over time.

4. The monitoring institution

The German monitoring institution is the Independent Advisory Board to the Stability Council (Advisory Board).

Set-up and statutory regime: The Advisory Board is grounded in law (Section 7 of the Stability Council Act, as amended by the Fiscal Compact Implementation Act) and attached to the Stability Council. That institutional set-up takes account of the federal structure of Germany. The Stability Council is composed of representatives of the governments of both the Federation and the *Länder* and is tasked among other things to review compliance with the upper limit of the structural general government budget deficit. It also coordinates budgetary and financial planning among the different levels of government and may issue recommendations for the purposes of coordinating budgetary and financial planning. The Stability Council revised its rules of procedure to formalise its relations with the Advisory Board[1]. The monitoring institution started its operations on 5 December 2013 and its own rules of procedure were adopted on 29 April 2014. The Advisory Board is composed of nine members and can rely on support staff from the secretariat of the Stability Council.

Mandate: According to Section 7(1) of the Stability Council Act, the Advisory Board is tasked to support the Stability Council. Section 7(3) of the same Act states that '*it shall issue*

[1] Section 7a in the rules of procedure (*Geschäftordnung*) of the Stability Council was added for that purpose.

an opinion on compliance with the upper limit for the structural general-government deficit. If it reaches the conclusion that the upper limit has not been complied with, it shall recommend suitable measures for eliminating the excessive deficit'. Through a chain of legal references which has been confirmed by the German authorities[2] (Section 7 of the Stability Council Act; Section 51(2) of the Budgetary Principles Act and Article 3(2) of the TSCG), the Advisory Board has been entrusted a broad-based mandate which covers the tasks foreseen by the Fiscal Compact and the common principles.

Comply-or-explain principle: The Stability Council's rules of procedure were amended in June 2016, adding subsection 6 within Section 7a, as a result of which the Stability Council must always take into account the assessment and recommendations of the Advisory Board and publicly explain diverging assessments and recommendations.

Freedom from interference and capacity to communicate: The independence of the Advisory Board is stated both in legislation (Article 2(7)(1) of the Fiscal Compact Implementation Act) and the rules of procedure of its hosting body, the Stability Council (Section 7a(1)). As to its capacity to communicate, Section 7(5) in the Stability Council's rules of procedure establishes that the Advisory Board's opinions and recommendations are public. The Advisory Board has a dedicated section within the Stability Council's website[3].

Nomination procedure: According to Section 7(2) of the Stability Council Act, the Advisory Board consists of: one representative each from the German Council of Economic Experts[4], the central bank and the research institutes that prepare the Joint Economic Forecast used as a basis for budgetary planning; four experts (*Sachverständige*) appointed on behalf of the Federal Government and *Länder* by their representatives on the Stability Council for a period of five years; and two experts appointed by associations of local authorities and the social security organisations for a period of five years.

Resources and access to information: The Fiscal Compact Implementation Act (Article 2(7)(1)) requires functioning costs to be shared in equal parts by the Federation and the *Länder*. On that basis, the Advisory Board is currently provided a budget capped at EUR 100 000 per year that is primarily used for funding academic staff members and external experts. An additional amount of up to EUR 40 000 is reserved for covering travel expenses. While the Advisory Board is expected to use the secretariat of the Stability Council for ancillary tasks, in the absence of dedicated staff the Advisory Board may as per its rules of procedure establish a scientific service, whose funding would be equally shared between the Federation and the *Länder*. The Advisory Board may also use the resources of the entities represented on the board. Provisions for access to information have been included in the rules of procedure of the Stability Council (Section 7a(2)). While its right to request information directly from institutions other than the Stability Council is not stated as such, the Advisory Board's access to information is secured as it receives statistics and estimates from the relevant working group of the Stability Council and may ask the secretariat of the Stability Council for further information[5].

Overall, the set-up of the German monitoring institution complies with the TSCG requirements and common principles. It is grounded in law with a broadly delineated mandate

[2] Letter from the German authorities of 15 September 2015.
[3] http://www.stabilitaetsrat.de/DE/Beirat/Beirat_node.html
[4] *Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung*
[5] The provisions for access to information should be read in conjunction with the obligation of the Federation and *Länder* to supply information to the Stability Council (Section 52 of the "Budgetary Principles Act" and Section 12(3) of the "Stability Council Rules of Procedures").

providing the basis for carrying out the tasks foreseen by the Fiscal Compact and the common principles. The legal framework includes appropriate safeguards for functional autonomy. The 'comply-or-explain' principle is enshrined in the Rules of Procedure of the Stability Council. Adequate provisions on the Advisory Board's endowment with resources and access to information are in place.

5. Conclusion

The national provisions adopted by Germany are compliant with the requirements set in Article 3(2) of the TSCG and in the common principles.