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ANNEX 5

**ANNEX**

**Country annex**

**DENMARK**

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**REPORT FROM THE COMMISSION**

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

## DENMARK

Denmark 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 19 July 2012.

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

- the Budget Law N°547 adopted on 12 June 2012 (Law No 547),
- the Law No 583 to Amend the Economic Council and the Environmental Economic Council of 18 June 2012 (Law No 583).

### 1. Legal status of the provisions

Law No 547 is an ordinary law without hierarchical supremacy over the annual laws passing the annual budget ("finanslove").

The Danish Constitution ("grundloven") foresees no supra-legislative category of laws whose status is between the Constitution and ordinary laws. The annual budget laws are in principle adopted following the same procedure as other laws (i.e. after three readings in parliament), and could validly repeal existing law provisions and lay down new norms (although this is not their primary purpose).

At political level, it is widely recognized that amendments of, or deviations from, existing material legislation should not take place via the budget laws. That general rule and some exceptions to it are defined in the Budget Guidelines ("Budgetvejledningen") issued by the Ministry of Finance. The Budget Guidelines however have the status of administrative practice (albeit longstanding and generally adhered to) and it is not legally excluded that an annual budget law could deviate from Law No 547.

As Danish law traditionally follows a dualistic approach to international treaties, it does not appear that the TSCG in itself constrains the budget authority when passing the annual budget laws.

The Danish authorities informed the Commission that there are no specific judicial remedies available in case of a breach of the annual budget bill with Law No 547.

The uncertainty and the apparent weakness of the available legal review should nevertheless be balanced by two important considerations.

Firstly, the Danish authorities gave a formal and public commitment that the national legal framework requires the annual budget bills to be adopted in compliance with the provisions of the TSCG and Law No 547<sup>1</sup>.

Secondly, the strict enforcement of Law No 547 appears also to be guaranteed by the robustness of the monitoring mechanism set up in accordance with the TSCG (see Section 4 below).

Against that background, and in the light of the positive assessment of the existence of an independent and operational monitoring institution, Denmark's provisions comply with the

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<sup>1</sup> Letter from the Danish authorities of 18 July 2016.

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 formulated in Chapter 2 of Law No 547.

The formulation follows closely the provisions contained in Article 3(1) of the TSCG. The general requirement set in Chapter 2(1) is that the "*Budgetary position with regard to overall public finances shall be in balance or shall show a surplus*". Chapter 2(2) specifies that that requirement is fulfilled if the structural balance is at the level of the medium-term objective (MTO) set out in accordance with the Stability and Growth Pact with a lower limit for a structural deficit of 0.5% of GDP. The provision of Law N°547 related to lower limits appears more stringent than the requirement from the TSCG, as the law does not include the lower limit of -1% of GDP in cases of low debt and low sustainability risks. The terms used in Chapter 2 (structural balance, overall public finances) are not further specified in the law. Chapter 4 authorises the Minister for Finance to lay down detailed rules on the method of determining the structural balance.

**Convergence towards the MTO:** Denmark has adequately converged to the MTO in conformity with the national provisions (Chapter 2(3) of the Law No 547). Potential deviations from the MTO are catered for by the correction mechanism.

**Escape clauses:** Chapter 2(5) states that a deviation from the MTO or the adjustment path is allowed in exceptional circumstances, provided that it does not endanger medium-term fiscal sustainability. Exceptional circumstances are defined in chapter 2(6) by replicating the wording of Article 3(2)(b) of the TSCG.

**Overall,** the balanced budget rule complies with the TSCG requirements. Its formulation follows closely the provisions of the TSCG (the absence of the lower limit for the MTO of -1% of GDP makes the national provisions more demanding and does not undermine compliance). While terms used to define the rule, such as the "structural balance" and the "overall public finances", are not fleshed out in Law No 547, they are specific enough to avoid ambiguity.

## **3. The correction mechanism**

The provisions relating to the correction mechanism are mostly found in Articles 2 and 3 of Law No 547, with provisions elsewhere in the law being relevant as well (notably on expenditure ceilings).

**Activation:** As confirmed by the Danish authorities, Article 2 of Law No 547 gives rise to an obligation to prepare each and every year an annual budget bill for the coming year under the constraint that the structural balance for the coming year is at the MTO and no lower than -0.5 percent of GDP. The provisions therefore imply that in the event of an observed deviation, the MTO must be restored as soon as the following year. Consequently, Article 2 should act as a strong ex ante rule automatically requiring presentation and adoption of budgets consistent with the structural balanced budget rule, irrespective of possible deviations in previous years.

Furthermore, every August the Ministry of Finance must issue a statement concerning the structural balance for the following year (Article 3). If it shows a significant deviation, the correction mechanism is automatically activated. Article 3 defines a significant deviation as a

negative deviation of at least 0.5% of GDP from the MTO or the adjustment path thereto, which is similar to the notion defined in the SGP. A national method is used to evaluate the structural balance and the existence of a significant deviation.

In addition, the monitoring institution, the Danish Economic Council (DEC), monitors the development in the public finances and compliance with Law No 547. While not given specific responsibility as to the correction mechanism in the legislation, the Danish authorities have confirmed that in practice the DEC is expected to assess whether activation of the correction mechanism is warranted.

**Substance of the correction:** Once the mechanism is triggered, the Ministry of Finance has to present a corrective plan for the following year. As noted above, the provisions imply that following any possible deviation, corrective action is taken for re-establishing a budgetary position at the MTO within one year. By construction this captures the notions of proportionality and MTO adherence encapsulated in the common principles. That corrective rule applies irrespective of the size of possible deviations. Article 3(5) further specifies that the corrective measures must imply an improvement in the structural balance of at least 0.5% of GDP. As confirmed by the Danish authorities, the size of correction would be higher in the event of larger observed deviations. Again, while it is not made explicit in the legislation, the DEC is in practice expected by the authorities to assess whether the correction is proceeding in accordance with national rules and plans.

In addition, Law No 547 (Chapters 3-4) has introduced multiannual (4 years) expenditure ceilings covering a large fraction (about three quarters) of general government spending (unemployment-related, investment and interest rate expenditures are excluded). There are control mechanisms with a view to ensuring compliant execution with those ceilings. Moreover, the system contains a degree of in-built ex post correction: overruns on the sub-ceiling of central operational expenditures must be compensated in the following year (Article 15(2)). Non-compliance with the sub-ceiling for income transfers (other than unemployment-related) may also be compensated in the following fiscal year. In the case of local governments, spending overruns may lead to a cut in the grants the following year. Those features imply that the system of expenditure ceilings may contribute to the operation of the correction mechanism.

**Overall:** The correction mechanism is compliant with the TSCG requirements and the common principles in light of the clarification provided by Danish authorities. Indeed, as confirmed by the Danish authorities, the provisions imply 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. In addition, the multiannual expenditure ceilings strengthen the credibility of the mechanism. The DEC may take a significant role in monitoring the application of these provisions, though that is not made explicit in the legislation.

#### **4. The monitoring institution**

The Danish monitoring institution is the DEC.

**Set-up and statutory regime:** The DEC is a stand-alone advisory body established in 1962, whose mandate was reformed through Law No 583, which entered into force on 1 January 2014. The DEC has been entrusted with assessing the sustainability of long-term public finances and the medium-term developments in the fiscal balance. The DEC is composed of a chairmanship ensured by four independent economists (acting as a board) and up to 22 members. The chairmanship is assisted in its work by a Secretariat.

**Mandate:** Through the adoption of Law No 583, the DEC has been given the tasks of assessing regularly the long-term sustainability of public finances, monitoring the medium-term developments in the fiscal balances (including the structural balance), and evaluating whether the spending limits are aligned with the fiscal targets for public finances as determined by parliament, i.e. to evaluate and monitor whether the planned and conducted fiscal policy is in accordance with the relevant provisions of Law No 547. Whereas the tasks foreseen by the Fiscal Compact and the common principles are not explicitly stated in the law, the DEC's general mandate provides the necessary basis for carrying them out, as also confirmed by the Danish authorities<sup>2</sup>.

**Comply-or-explain principle:** No legal provisions oblige the government to comply with the DEC's recommendations or explain publicly any departures from them. With a view to guaranteeing full respect and adherence to the 'comply-or-explain' principle throughout the national budgetary process, the Danish authorities have formally committed that the Danish legal framework would be consistently applied in line with the 'comply or explain' principle, so that the government would consistently comply with the assessments and recommendations of the DEC or alternatively publicly explain why it departs from them<sup>3</sup>.

**Freedom from interference and capacity to communicate:** The annotations to Law No 583 set out the DEC's role as an independent monitoring institution for the structural balanced-budget rule. The chairmanship and the secretariat are independent from the government, the other DEC members, and other special interests. The DEC has the capacity to communicate freely. Every year the DEC must hold at least two meetings (in May and October)<sup>4</sup>, for which the chairmanship must prepare a report containing economic analyses and policy statements, including on fiscal policy. The chairmanship has the sole responsibility for the reports and decides on them on the basis of consensus. After the meetings the chairmanship publishes on the DEC's webpage<sup>5</sup> its report, including an appendix with contributions from other members.

**Nomination procedure:** The four members of the DEC's chairmanship are independent economic experts (generally university professors of economics), formally appointed by the Minister of Economic Affairs for a period of up to 6 years (non-renewable). They cannot be members of the Danish Parliament. The other members of the DEC, which are appointed by the Minister for Economic Affairs for a period of up to 3 years, consist of 17 representatives nominated by the central bank, government, employer's federations and unions, as well as three academic experts.

**Resources and access to information:** The DEC is financed by a one-year binding appropriation on the fiscal bill financed by tax revenues. While Law No 583 does not contain provisions about DEC's access to information, the annotations to Article 1 of Law No 583 state that access to resources and data necessary for the DEC to carry out its mandate will be ensured; the Danish authorities have confirmed that the annotation is followed through by ongoing dialogue between the Ministry of Finance and the DEC. A Secretariat employing 20-25 economists assists the chairmanship in preparing its reports.

**Overall,** the set-up of the Danish monitoring institution is compliant with the TSCG requirements and common principles in light of the formal commitment provided by the national authorities to apply the comply-or-explain principle in line with the common

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<sup>2</sup> Letter from the Danish authorities of 9 September 2015.

<sup>3</sup> Letter from the Danish authorities of 18 July 2016.

<sup>4</sup> Additional meetings can be called at the chairmanship's request or at the request of at least three other members.

<sup>5</sup> <http://www.dors.dk>

principles. The DEC is grounded in law and is endowed with appropriate safeguards as to its functional autonomy. Its broadly delineated mandate provides the necessary basis for carrying out the tasks prescribed by the TSCG and the common principles. A 'comply-or-explain' principle as envisaged in the common principles is not explicitly enshrined in the law. However, the Danish authorities have formally committed to consistently apply the national legal framework in line with that principle. The DEC's endowment with resources and its access to information are properly secured.

## **5. Conclusion**

The national provisions adopted by DK are compliant with the requirements set in Article 3(2) of the TSCG and in the common principles in light of the formal commitment provided by the national authorities that the Danish legal framework obliges the annual budget bills to be adopted in compliance with the provisions of the TSCG together with the compliant set-up of the monitoring institution, of the clarifications provided by national authorities on the correction mechanism and of the formal commitment provided by national authorities to apply the comply-or-explain principle in line with the common principles.