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ANNEX 4

ANNEX

Country annex

CYPRUS

to the

REPORT FROM THE COMMISSION

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

CYPRUS

Cyprus 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 26 July 2012.

The national provisions considered in this assessment are mostly those provided for by the Constitution and the Fiscal Responsibility and Budget Framework Law of 21 February 2014 (FRBFL). The FRBFL incorporates and complements provisions of the Medium-Term Budgetary framework Law of 21 December 2012.

1. Legal status of the provisions

Article 113 of the FRBFL specifies that the provisions of the FRBFL "apply notwithstanding the provisions of any other law, general or special, previous or subsequent". Moreover, the recitals of the FRBFL recognise that it is enacted for the purposes of the implementation of Cyprus' obligations as a contracting party to the TSCG, which has been ratified and published in the Official Gazette of the Republic of Cyprus (Official Gazette). However, for the purposes of Cyprus' legal order, the FRBFL is an ordinary law, which has the same hierarchical status as a budgetary law.

It is therefore necessary to assess whether the budget authorities are directly and effectively bound by the TSCG itself.

Under Cyprus' legal order there is no intermediary legislation between the provisions of the Constitution and ordinary legislation. The hierarchy in Cyprus legal order is a) Constitution, b) conventions/treaties and c) ordinary laws. Article 169(3) of the Constitution provides that treaties, conventions and agreements concluded under the provisions of that Article have superior force, as of the day of their publication in the Official Gazette of the Republic (OG), over any national law (ordinary law), on condition that they are applied by the other Party. A convention does not *stricto sensu* override an ordinary law but has only superior force to it in the sense that it has precedence in its application. It retains its nature as part of the international law.

Because the TSCG is a treaty which fulfils the conditions set by Article 169 of the Constitution, it enjoys a superior force over national legislation.

As regards judicial control of the legality of legislation, except for a specific case provided for in the Constitution, according to which the President of the Republic may refer to the Supreme Court of Cyprus a question of whether a law is inconsistent with a provision of the Constitution (a priori control) before its publication in the OG, Cypriot law does not lay down a general duty to refer questions of constitutionality to the Supreme Court. As concerns subsequent control of constitutionality, it is noted that the Supreme Court has no monopoly to declare a law unconstitutional. All Cypriot Courts have the power to review the constitutionality of laws as well as the constitutionality and legality of ordinary laws if raised in a case before them and are not required to obey provisions enacted in abolition of the Constitution.

However, the Cypriot authorities have not established that such an action would constitute an effective legal remedy in the case of a discrepancy between an annual budget law and the

TSCG or the FRBFL. It has not been established either if and under what conditions an action to review the legality of the annual budget law for violation of the FRBFL is available under Cypriot law.

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

Firstly, the Cypriot authorities formally committed that they support an interpretation of the FRBFL consistent with the Fiscal Compact. The Commission takes positive note of that commitment. In addition, they informed the Commission that that commitment would be reiterated through a decision of the Council of Ministers which would be published in the Official Gazette¹. The comfort given to the Commission by that commitment is strengthened by the announced publication which should reinforce the status of the FRBFL in domestic law.

Secondly, the strict enforcement of the FRBFL appears also to be guaranteed by the robustness of the monitoring institution set up in accordance with the TSCG (see section 4 below).

Against that background, and in the light of the commitment provided by the national authorities to interpret the FRBFL consistently with Article 3(2) of the TSCG together with the compliant set-up of the monitoring institution, Cyprus' 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 set out in Articles 40 to 42 of the FRBFL.

Article 40 of the FRBFL requires compliance with one of the following rules each financial year: (i) budgetary position rule, or (ii) corrective adjustment rule. The budgetary position rule is set out in Article 41 and its formulation follows closely the text of the TSCG. Specifically, it defines the budgetary position rule as a structural balance, which is balanced or in surplus in the medium term. That requirement is considered met if the annual structural balance of the general government has achieved the medium-term objective (MTO). Article 41(3) sets the lower limits for the MTO in line with the TSCG-specific lower limits. Article 41(4) contains provisions regulating the regular updates of the MTO referring to "*the procedures laid down in the Stability and Growth Pact*". All the terms, including the MTO and the structural balance, are defined in Article 2, referring to Regulation (EC) No 1466/97.

Part V of the FRBFL contains provisions linking the budgetary rules to the preparation of the central budget, while Parts XII and XIII set out rules for other entities of the general government sector.

Convergence towards the MTO: As Cyprus reached the MTO after the FRBFL entered into force, it is the provisions on deviations from the MTO, i.e. the correction mechanism, which are relevant.

Escape clauses: Articles 41(5) and 42(3) specify that the deviation from – respectively – the MTO and the adjustment path towards it may be allowed only under special circumstances, provided that such deviation does not jeopardise the sustainability of public finances in the

¹ Letter from the Cypriot authorities of 25 July 2016.

medium term. "Special circumstances" are defined in Article 2(1) in line with the definition of the "exceptional circumstances" contained in the TSCG.

Overall, the balanced-budget rule complies with the TSCG requirements.

3. The correction mechanism

The provisions relating to the correction mechanism are mostly found in Articles 44 to 46 of the FRBFL.

Activation: Article 44(1) of the FRBFL specifies that the correction mechanism is automatically triggered if the Commission addresses a warning to Cyprus under Article 6(2) of Regulation (EC) No 1466/97. Article 44(1) of the FRBFL additionally provides that the Minister of Finance may also activate the correction mechanism on its own initiative if it identifies a significant deviation from the MTO or the adjustment path thereto, with the notion of significant deviation referring to Regulation (EC) No 1466/97. Moreover, the Fiscal Council is explicitly mandated (Article 44(2)) to assess the existence of significant deviations, and the government must take position *vis-à-vis* those assessments.

Substance of the correction: In the event of activation, the Minister of Finance has to prepare and submit to the government within one month a corrective plan which is then submitted to Parliament in the form of an amended budget (Article 45(1)). The plan must set out the timeframe for the correction, annual budgetary targets, and revenue and expenditure measures.

The requirements for the corrective plan focus on ensuring compliance with Union rules and decisions. The provisions require that the correction plan be consistent with the Stability and Growth Pact and recommendations from the Union institutions based thereon (Article 45(2)). The legislation also requires the corrective plan to be consistent with the current stability programme.

The main characteristic of the arrangement is to focus on consistency of the national mechanism with Union recommendations. The legislation does not contain specific national corrective rules. The duty to strictly abide by recommendations made by the Union institutions is thus the principal means to ensure compliance with the TSCG requirement of correcting the deviations "over a defined period of time" and with the common principles.

Finally, the Fiscal Council is explicitly tasked with assessing at least twice-yearly the implementation of the corrective plan, and its consistency with the correction of significant deviations.

Overall: The correction mechanism is compliant with the TSCG requirements and the common principles. It stresses consistency with the Union budgetary surveillance framework, whereby the activation and substance of the correction are linked to recommendations made by the Union institutions. There are no specific national provisions on the substance of the correction in the legislation. The Fiscal Council is given a significant role in monitoring the correction mechanism.

4. The monitoring institution

The Cypriot monitoring institution is the Fiscal Council.

Set-up and statutory regime: The Fiscal Council is grounded in the FRBFL. According to Article 18(2) of the FRBFL, the Fiscal Council is a public entity. It is composed of three members including a president, supported by dedicated staff. The members were nominated

by the Council of Ministers in April 2014 and the Fiscal Council started its operation in Autumn 2014.

Mandate: According to Article 19 of the FRBFL, the Fiscal Council is entrusted *inter alia* with the monitoring of compliance with national numerical fiscal rules (including the structural balanced budget rule). In that respect, the Fiscal Council is required to provide assessments in relation to both the activation of the correction mechanism for the structural balanced budget rule and progress with its correction, as well as on the triggering or termination of exceptional circumstances. As part of its broader mandate, the Fiscal Council also provides ex ante assessments of macroeconomic and budgetary forecasts.

Comply-or-explain principle: Pursuant to Article 46(6) of the FRBFL, if the Ministry of Finance does not follow the recommendations of the Fiscal Council, it must publicly provide explanations for that decision.

Freedom from interference and capacity to communicate: Articles 18(3) and 22 of the FRBFL provide that the members and staff of the Fiscal Council do not take instructions from any person or organisation. The Fiscal Council communicates through its public reports and opinions, which are published on its website². In addition, the Fiscal Council may appear before parliamentary committees for matters related to its functions.

Nomination procedure: The leadership of the Fiscal Council is composed of three members appointed by the Council of Ministers, after consulting the parliamentary committee for finances and budget. The President is nominated for six years, while the two other members work on a part-time basis (and with terms of five and four years respectively). The members of the Fiscal Council may be appointed for a maximum of two consecutive terms. Eligibility criteria pursuant to Article 21(1) of the FRBFL include a long experience and a significant academic background in public finance and economics. Conflict-of-interest rules, given effect by a declaration of interest and possible sanctions for non-compliance, and incompatibilities apply. The Council of Ministers may dismiss a Fiscal Council member in case of mental or physical incapacity or long-term absenteeism, after the opinion of an *ad hoc* legal committee (Article 23 of the FRBFL) and having provided a reasoned opinion.

Resources and access to information: In terms of dedicated human resources, between three and six staff positions can be filled. Funding for the Fiscal Council comes from the general budget; Article 32(2) lays down that the budget "*adequately reflects the staffing and resources proposed by the President of the Council, as provided for in the annual plan for the performance of the Council's duties*". As to access to information, the Fiscal Council may request all the necessary information from any government entity. A definition of the core information needed for the Fiscal Council to discharge its tasks is laid down in Article 30(2) of the FRBFL, the non-communication of which may constitute an offence.

Overall, the set-up of the Cypriot monitoring institution is compliant with the TSCG requirements and common principles. The Fiscal Council is grounded in law and its mandate includes the tasks prescribed by the TSCG and the common principles. The legal framework stipulates appropriate safeguards for functional autonomy. The comply-or-explain principle is explicitly provided for in the law. Adequate provisions on the Fiscal Council's endowment with resources and access to information are in place.

² http://www.fiscalcouncil.gov.cy/fiscalcouncil/fiscalcouncil.nsf/index_en/index_en?OpenDocument

5. Conclusion

The national provisions adopted by Cyprus 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 to interpret the FRBFL consistently with Article 3(2) of the TSCG together with the compliant set-up of the monitoring institution.