

## Legal opinion on the reform of the cyclical component of the debt brake

Dezernat Zukunft has devised a reform proposal to adjust the method of calculating the cyclical component of the constitutional debt brake ([Schuster et al. 2021](#)). (A FAQ on the most important facts can be found [here](#). The constitutionality and legal feasibility of the proposal were reviewed by Professor Stefan Koriath and Dr. Michael Müller.

The cyclical component increases or decreases the maximum permissible annual net borrowing depending on whether the level of economic activity is below or above the 'normal level'. In the simple law and the regulation which further specify the constitutional rule the 'normal level' is translated into the economic concept of 'potential output', which is then elaborated on as 'the GDP that can be achieved with normal utilization of the production factors'. This is then translated into practice with an output gap calculation largely based on the EU's Commonly Agreed Methodology. Schuster et al. suggest that instead of using statistical extrapolation to update certain input values to calculate the cyclical component, it should be set, explicitly, in coherence with political goals. Specifically, they suggest that the calculation of the potential labor input should: (1) be guided by the goal of full employment; (2) assume an increased female participation rate; and (3) take into account the working time preferences of those who involuntarily work part-time.

The opinion shows that the constitutional framework of the debt brake leaves room for interpretation of the cyclical component of the debt brake. This particularly relates to the definition of the 'normal level', for which hypothetical assumptions must be made, but not unrealistic ones: the target that is set has to be attainable. When devising or applying the cyclical component, the 'normal level' must not be turned into an 'ideal level'. (Moreover, there is in fact a limit on net borrowing: if the deficit is larger than 1.5% of GDP it would have to be paid back in line with the business cycle.) However, the cyclical component in its current form does not make provisions for the input factors and the assumptions on which they are based: *"The synopsis of the regulations shows that the assumptions about the 'normally utilized production factors labor and the capita stock' to be entered into the cyclical adjustment procedure are ultimately not subject to any formal or substantive legal stipulation."*

On this basis, the opinion finds that the proposal by Schuster et al. is within the constitutionally prescribed framework, and that the assumptions underlying the proposal were, in fact, consistent with the values of the constitution. Because the input factors have so far been defined at the implementation level, the proposal could, in principle, be implemented within the current system without any legal adjustments.

However, the experts do express doubts about the compatibility of the current specification of the cyclical component in ordinary law and the corresponding regulation with the parliamentary scrutiny reservation. In view of the *"considerable impact that different assumptions"* can have (including on the extent of permissible net borrowing) they argue that the determination of these assumptions is a key decision and that *"it is therefore the task of the parliamentary legislator to determine the factors concerning the assumptions to be made"*. Therefore, in their view, a legal implementation of the proposal by Schuster et al. at the level of ordinary law would be preferable. Finally, in the opinion of the experts, clarification should be

provided at the legislative level (or at least in the corresponding regulation) in case adopting the proposal leads to a deviation from the method applied by the European Commission in the context of the Stability and Growth Pact.