

Germany: the Constitutional Court deprives the government of €60 billion earmarked for transformation

Michał Kędzierski, Sebastian Płóciennik

On 15 November the Federal Constitutional Court (FCC) in Karlsruhe ruled that the reallocation of the unused debt from the pandemic support measures to the Energy and Climate Fund (currently known as the Climate and Transformation Fund; *Klima- und Transformationsfonds*, KTF) was contrary to the German Constitution.

In 2020, during the crisis caused by COVID-19, the so-called debt brake (*Schuldenbremse*) was suspended for three years, and the government was allowed to increase debt to combat the economic crisis caused by the pandemic. The 2021 budget envisaged a debt of up to €240 billion. It turned out at the end of the year that €60 billion from this pool had not been spent. Formally, unused loans should be written off. In February 2022, the new SPD-Greens-FDP government coalition voted to amend the 2021 budget in the Bundestag. As a result, these funds which were recorded as debt in 2021 were transferred to the KTF (raising its budget from €42.6 billion to €102.6 billion) as resources to be allocated in the coming years, primarily for purposes linked to the energy transformation. Deputies from the opposition CDU/CSU contested the amendment in the Constitutional Court. They argued that the credit lines in question could only have been used to deal with the effects of the pandemic, since this was the reason for suspending the debt brake, and the coalition's move represented an illegal bypass of the law.

The FCC judges gave three reasons for their decision. Firstly, there was no convincing link between the new allocation of the funds and the original goal. Secondly, there was a significant gap between the time when the emergency-related debt was incurred and the period when it was to have been spent. Thirdly, the retroactive effect of the decision (the amendment to the 2021 budget) was adopted in February 2022, and so after the end of the fiscal year. Therefore, the court ruled, the government had no right to incur a new debt that had been shifted from the pandemic fund, thus reducing the KTF's resources by €60 billion. On the same day, the German government carried out the court's recommendation: it suspended (with some exceptions) the spending of the funds from the KTF, and announced it would put forward a new expenditure plan in the near future.

The KTF is a special fund earmarked for financing the broadly understood energy transformation: it includes subsidies for the thermal modernisation of buildings and replacement of heat sources, the development of electromobility, the decarbonisation of industry, the expansion of the railway network, subsidies for renewable energy sources (*EEG-Umlage*), stimulating investments in hydrogen technologies, and even building

semiconductor factories in Magdeburg (Intel) and Dresden (TSMC). The main sources of KTF's revenues are the sale of CO₂ permits as part of the EU ETS, and the national emissions trading system for the buildings and transport sectors.

Commentary

- The significant depletion of the KTF's budget is a serious problem for Berlin when it comes to further financing of the energy transformation. This fund, largely thanks to the reallocation of the pandemic debt, has become very important for the government coalition as a financial instrument supporting the implementation of projects as part of the *Energiewende* in various sectors of the economy. The KTF envisages a total spending of €212 billion in 2024–7 alone. Slashing the KTF's budget by almost 30% will severely affect its existing model of operation, and will force the coalition partners not only to reform the fund itself (significant cuts in expenses and/or transfer of their part to the regular state budget seem inevitable), but also to devise a new long-term strategy for financing the transformation expenses.
- The Constitutional Court's decision has a macroeconomic dimension as well. Much depends on whether the expected cuts in the KTF will primarily affect the financial plan for 2024 (so far, it has assumed spending of €57.6 billion next year) or will be distributed evenly over the following years. If the former scenario is chosen, this may have serious repercussions for the economy, which is already struggling with recession. In addition to the goals related to the energy transformation, KTF expenditures also provide a fiscal impulse which will boost demand in the economy. The sum in question is equivalent to 1.5% of Germany's GDP, and without it, recovery from the crisis will certainly take longer.
- The Constitutional Court's ruling heralds another heated dispute inside the SPD-Greens-FDP coalition. In political terms, the KTF was used primarily to support various political initiatives of the Green Party, while the other coalition partners resorted to it to a much lesser extent. Therefore, the major cut in its budget will particularly put the Greens under political pressure to defend the projects that are important to them. In the negotiations within the coalition that have already started, they will try to limit the necessary cuts to a minimum and push to find other ways of finding the money, for example by raising certain taxes or tariffs or eliminating selected tax reliefs (for instance, for diesel cars), or even suspending the debt brake again. The FDP will certainly oppose these ideas. Moreover, this serious depletion of the KTF's resources has significantly limited the government's financial abilities to implement new projects in the second half of its term, which will further strain relations between the coalition partners.
- The dispute will reverberate even more widely within Germany. The Constitutional Court's ruling has disrupted the fragile balance inside the government coalition. That balance was based on reintroducing the debt brake on the federal budget, as demanded by the FDP, and increasing actual spending thanks to special funds, which in turn satisfied the SPD and the Greens. The ruling therefore means the return of the fundamental dispute about the future of the debt brake. Its critics (the Greens and the SPD) will strive for a reform aimed at making the regulations more flexible and introducing permanent exceptions, such as expenditure on energy transformation. On the other hand, the court has strengthened supporters of the literal interpretation of the brake rules and restrictive

budget policy (the FDP and the opposition CDU/CSU). From their perspective, the court's ruling means the need to reform public finances, and thus opens a debate on the role of the state in areas such as the economy, taxes and social policy.

- The Federal Constitutional Court's decision will also have serious repercussions in the European Union. Negotiations are currently underway on the need to reform the Stability and Growth Pact which sets the rules for fiscal discipline. The European Commission and southern EU countries have demanded greater flexibility in determining debt reduction paths and making exceptions, for example for defence spending. Germany insists on maintaining the restrictive formulas, and is setting its own restoration of the debt brake as an example which others should follow. The court's verdict has undermined Germany's arguments, revealing that its showcased return to restrictions is in fact the result of creative accounting, not real savings. Berlin's representatives will have to face questions from their partners as to how they intend to finance strategic expenses in difficult times for Europe, while sticking to the narrow legal interpretation imposed by the Constitutional Court's judges. Germany will also find it more difficult to reject arguments for the creation of a large European fund to finance important investments that would help relieve the burden on national budgets.