COMMISSION OF THE EUROPEAN COMMUNITIES

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Recommendation for a

COUNCIL RECOMMENDATION

with a view to giving early warning to Germany in order to prevent the occurrence of an excessive deficit

and

Proposal for a

COUNCIL DECISION

making public this Recommendation

(presented by the Commission)

EXPLANATORY MEMORANDUM

The strengthened surveillance of budgetary positions under Council Regulation (EC) No 1466/97[1] as part of the Stability and Growth Pact includes an early warning system under which the Council will alert a Member State at an early stage to the need to take the necessary budgetary corrective action in order to prevent a government deficit becoming excessive. Article 6 of the regulation sets out, for Member States participating in the single currency, how the early warning system is applied. Regular monitoring by the Council of the implementation of stability programmes is carried out in particular with a view to identifying actual or expected significant divergence of the budgetary position from the medium-term objective, or the adjustment path towards it, as set in the programme for the government surplus/deficit. In the event that the Council identifies significant divergence then, with a view to giving early warning in order to prevent the occurrence of an excessive deficit, it addresses a recommendation to the Member State concerned to take the necessary adjustment measures. This early warning is made in accordance with the procedure of Treaty Article 99(4) and is based on a recommendation from the Commission.

The Commission considers that there is significant divergence when latest estimates and forecasts for the government balance in the most recent and current or future years are appreciably worse than the targeted adjustment path set by the Member State in its preceding stability programme, in a situation in which the Member State's budgetary position is not yet consistent with the medium-term budgetary objective of close to balance or in surplus required by the Stability and Growth Pact. In these circumstances, a further deterioration in the government deficit must be prevented in order to avoid the risk of an excessive deficit and there is a need to get back on track towards a sound medium-term budgetary position. The sources of deviations from plans, particularly the role of cyclical developments, must also be examined and will have relevance for assessing the appropriate policy response.

The second updated stability programme submitted by Germany in October 2000 aimed for a government deficit of 1½% of GDP in 2001 following a deficit of 1% in 2000 (excluding UMTS proceeds). In 2002 and subsequent years the deficit was planned to narrow by ½% of GDP each year to reach balance in 2004. The deterioration expected in the deficit in 2001 was explained by the tax reductions introduced from the beginning of that year. The deficit projections were made on the assumption of annual real GDP growth of 2¾% in 2001 and 2½% in the following years.

In the event economic growth slowed sharply in 2001; the first official estimate is that real GDP rose by only 0.6%. The government deficit widened by much more than planned in 2001, reaching 2.6% of GDP according to the first official estimate, following a slightly weaker than originally expected outturn of 1.3% of GDP in 2000.

Revised government plans in the third updated stability programme submitted by Germany in December 2001 aim for a government deficit of 2% of GDP in 2002 (compared with 1% in the previous update). The medium-term objective of reaching balance in 2004 is maintained. But the projection for 2002 is made against assumed real GDP growth of 1¼%, which seems likely to prove too optimistic. The latest economic forecasts by the Commission services, published in November 2001, show growth of only 0.7% in 2002 and a corresponding

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[1] Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies, OJ L 209, 2.8.1997, p. 1.

government deficit of 2.7% of GDP, implying a further slight widening of the deficit from 2001.

The deviation of the deficit outturn in 2001 from the target in the October 2000 updated stability programme can be explained entirely by the weakening in growth which has depressed tax revenues; there was also an upward revision to the deficit figure for 2000. On available information total general government expenditure has developed broadly in line with intentions, although there appears to have been some overshooting of spending plans in the health sector and in some States (*Länder*). Nonetheless, due to the tax reduction decided earlier which was already included in the October 2000 updated stability programme on which the Council delivered a favourable opinion[2], there was a clear deterioration in the structural deficit in 2001. The tax reduction was only planned to be compensated to a limited extent by expenditure restraint. According to the method of the Commission services the cyclically adjusted budget deficit widened to some 2¼% of GDP in 2001 and is forecast to improve slightly to 2% of GDP in 2002. This is above balance in the general government finances and providing insufficient margin for not breaching the 3% of GDP threshold in the event of further unfavourable surprises on economic growth.

The Commission considers that the sizeable shortfalls from the October 2000 updated stability programme plans already evident in 2001 and forecast in 2002 constitute significant divergence which could lead to the occurrence of an excessive deficit. This calls for the activation of the early warning system for the case of Germany.

With the German economy in a fragile state close to stagnation, it would not be desirable to introduce immediately sizeable adjustment measures which could weaken the economic cycle further. While the slowdown continues the German government should implement its budgetary plans for 2002 cautiously in order to avoid a further deterioration in the deficit. Moreover, any measures likely to lead to a further deterioration in the deficit should be avoided. Once recovery is seen to be under way, then the German government should strengthen its efforts to move rapidly towards its medium-term objective, pursuing tighter expenditure limits particularly in the budgets for 2003 and 2004. This will be all the more necessary since further tax cuts are planned for 2003 and must also be financed.

The Commission has adopted a recommendation for a Council recommendation giving an early warning to Germany, and is passing it to the Council for decision. The Commission considers that, in the interests of openness and transparency, the Council early warning should be made public and has also adopted a proposal for a Council decision to this effect, in accordance with the provisions of Treaty Article 99(4).

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2 OJ C 374, 28.12.2000, p. 4.

Recommendation for a

COUNCIL RECOMMENDATION

with a view to giving early warning to Germany in order to prevent the occurrence of an excessive deficit

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 99(4) thereof,

Having regard to the recommendation of the Commission,

Whereas:

(1) Article 6 of Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and co-ordination of economic policies[1] as part of the Stability and Growth Pact establishes an early warning system for alerting a Member State at an early stage to the need to make the necessary budgetary adjustment to prevent a government deficit becoming excessive. An early warning shall be given in accordance with Article 6(2) when the Council identifies actual or expected significant divergence of the budgetary position in a Member State from the medium-term budgetary objective, or the adjustment path towards it, set in the Member State's stability programme for the government surplus/deficit.

(2) In the Resolution on the Stability and Growth Pact adopted in Amsterdam on 17 June 1997[2] the European Council invited all parties to implement the Treaty and the Stability and Growth Pact in a strict and timely manner.

(3) Germany in October 2000 submitted its second updated stability programme on which the Council delivered an opinion on 27 November 2000[3]. This updated programme aimed for a government deficit of 1½% of GDP in 2001, 1% in 2002 and ½% in 2003 and for a zero government balance in 2004.

(4) The government deficit in Germany in 2001 is now estimated at 2.6% of GDP. The third updated stability programme submitted by Germany in December 2001 now aims for a government deficit of 2% of GDP in 2002 and 1% in 2003 and maintains the objective of a zero government balance in 2004. The Commission services in November 2001 forecast a government deficit of 2.7% of GDP in 2002.

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1 OJ L 209, 2.8.1997, p. 1.
2 OJ C 236, 2.8.1997, p. 1.
3 OJ C 374, 28.12.2000, p. 4.

(5) The shortfall of the government deficit in 2001 relative to the target of the October 2000 updated stability programme can be entirely explained by the much slower economic growth in 2001 than originally expected; there was also an upward revision to the deficit figure for 2000. Real GDP in Germany rose by 0.6% in 2001, compared with 2¾% expected in the October 2000 updated programme. In 2002 growth is forecast to again be much slower than the 2½% in the October 2000 updated programme.

(6) Adjusted for the impact of cyclical fluctuations, the underlying government deficit, as estimated by the Commission services, at 2% of GDP or more in 2001 and 2002 remains above balance in the general government finances and provides insufficient margin for not breaching the 3% of GDP nominal deficit laid down in the Treaty in the event of further unfavourable developments.

(7) The sizeable deviations from plans for the government deficit in 2001 and 2002 are evidence of significant divergence in terms of Article 6(1) and (2) of Council Regulation (EC) No 1466/97.

(8) There is a need for an early warning to be given alerting Germany in order to prevent the occurrence of an excessive deficit.

HEREBY RECOMMENDS:

1. The German government should closely monitor budgetary developments at all levels of government in 2002, including the States (*Länder*) and the social security system. It should implement its budgetary plans for this year carefully in order to avoid a further deterioration in the deficit. Therefore, any measures likely to lead to a further deterioration in the government deficit should be avoided.

2. Once economic recovery is established, the German government should strengthen its efforts to move rapidly towards its medium-term objective of a zero deficit in 2004. This will require limiting expenditure growth in the budgets for 2003 and 2004.

This recommendation is addressed to Germany.

Done at Brussels, […]

For the Council
The President
[…]

Proposal for a

COUNCIL DECISION

making public the recommendation with a view to giving early warning to Germany in order to prevent the occurrence of an excessive deficit

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 99(4) thereof,

Having regard to the proposal of the Commission,

Whereas:

(1) On [...2002], the Council adopted its recommendation with a view to giving early warning to Germany in order to prevent the occurrence of an excessive deficit, addressed to the German Government.

(2) The Council considers that making public the recommendation will facilitate the surveillance and co-ordination of economic policies of Member States and the Community and will contribute to a better understanding among economic agents, facilitating the implementation of the recommended measures,

HAS DECIDED AS FOLLOWS:

Article 1

The Council recommendation of [....2002] with a view to giving early warning to Germany in order to prevent the occurrence of an excessive deficit shall be published in the *Official Journal of the European Communities.*

Article 2

This Decision shall take effect on [.....2002].

Done at Brussels, [...]

For the Council
The President
[...]