COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 18.11.2003
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EU RESTRICTED

Recommendation for a

COUNCIL DECISION

establishing, in accordance with Article 104(8) of the EC Treaty, that the action taken by Germany in response to the recommendations made by the Council pursuant to Article 104(7) of the Treaty is proving to be inadequate

(presented by the Commission)

EXPLANATORY MEMORANDUM

The excessive deficit procedure for Germany

The excessive deficit procedure (EDP) is governed by Article 104 of the Treaty and by Regulation (EC) N°1467/97 of 7 July 1997 on the speeding up and clarifying the implementation of the excessive deficit procedure, which is part of the Stability and Growth Pact. It is completed by the political commitments enshrined in the Resolution of the Amsterdam European Council on the Stability and Growth Pact of 17 June 1997.

The Commission initiated the Excessive Deficit Procedure for Germany on 19 November 2002, with the adoption of the Report foreseen in Article 104(3) of the Treaty. This step was based on the Commission's Autumn economic forecast published on 13 November 2002, which projected for Germany a general government deficit of 3.8% of GDP for 2002, indicating a clear excess of the reference value of 3% of GDP. The updated Stability Programme of Germany, received by the Commission on 18 December 2002, confirmed a government deficit figure of 3 ¾ % of GDP for 2002. In the notification of 29 August 2003, the deficit estimate for 2002 was meanwhile revised down to 3.5% of GDP.

The Commission, taking into account the EFC opinion on its Article 104(3) Report, adopted on 8 January 2003 an Opinion on the basis of Article 104(5) concluding that an excessive deficit exists in Germany and recommended to the Council to take a decision in conformity with Treaty Article 104(6). On 21 January, the Council decided accordingly. In addition, in the terms of the Stability and Growth Pact, the Council adopted that same day based on a Commission recommendation a recommendation addressed to Germany with a view to bringing an end to the situation of an excessive government deficit, according to Article 104(7).

In its Article 104 (7) Recommendation of 21 January, the Council called upon *"the German government to put an end to the present excessive deficit situation as rapidly as possible in accordance with Article 3(4) of Council Regulation (EC) No 1467/97",* meaning that the deficit should be brought below 3% of GDP by 2004. Furthermore, the Council recommended "*the German authorities to implement with resolve their budgetary plans for 2003 which, on the basis of GDP growth projections of 1 ½ % in 2003, aim at reducing the general government deficit in 2003 to 2 ¾% of GDP; in particular, the German authorities should ensure a rigorous budgetary execution and a thorough implementation of the measures announced for 2003 amounting to 1% of GDP."* The Council established *"a deadline of 21 May 2003 at the latest for the German government to take such measures. If some of these measures are not implemented, the German government should adopt and implement compensatory measures to ensure a reduction of the government deficit in 2003 as planned. In addition, the Council recommends the German authorities to ensure that the rise in the debt ratio is brought to a halt in 2003 and reversed thereafter*." These recommendations were confirmed in the Broad Economic Policy Guidelines for 2003 adopted by the Council on 26 June 2003. Germany has made the Recommendation public.

On the basis of information available at the expiration of the deadline of 21 May, it was concluded that the German government had adopted measures of budgetary consolidation amounting to close to 1% of GDP. As a consequence, the Commission at the time did not recommend to the Council to take action with respect to Article 104(8) of the Treaty.

Application of Article 104(8) on the basis of the Autumn Forecast by the Commission

Compliance with the Article 104(7) recommendation has to be assessed under two aspects: developments in 2003, namely the implementation of the consolidation package and the commitment to rein in the rise in debt levels; and the target for the 2004 deficit.

Budgetary adjustment in 2003

Taking into consideration the German EDP notification of 29 August 2003, the Commission, in its Autumn 2003 forecast, published on 29 October, projects for 2003 a general government deficit of 4.2% of GDP. The figures of the forecast mark a deterioration vis-à-vis the 2002 deficit by 0.7 percentage points in nominal terms. About 0.6 percentage points of the deterioration are a result of the cyclical downturn and 0.1% of a worsening in the cyclically adjusted balance.

An analysis by the Commission of the shortfall in budget consolidation compared with earlier expectations comes to the conclusion that Germany implemented the required consolidation package, without which the 2003 deficit would have been well above 4 ¾ % of GDP. The fact that, nevertheless, the cyclically-adjusted balance deteriorated slightly can be attributed in particular to a downward revision in potential growth, as well as to a budgetary impact of the measures taken being lower than anticipated and a higher trend deficit due to the fact that growth turned out lower than expected in the Stability Programme on which expenditure plans were based.

In parallel to the deterioration in the overall budget balance, the Commission forecast also predicts a significant increase in general government debt, from 60.3 % of GDP in 2002 to 63.8% of GDP in 2003, compared with 62.7 % of GDP projected in Spring 2003. The non-achievement of the 2003 debt target of the Council recommendation has the same underlying reasons as that of the deficit target.

In short, while the German authorities followed the recommendations under Article 104(7), their action did not lead to the expected reduction in the cyclically-adjusted deficit and the stabilisation of the debt level in 2003 that would have laid the base for attaining the 2004 target.

Targets for 2004

The Commission, in its Autumn 2003 forecast, projects for 2004, on the basis of 1.6 % GDP growth, a general government deficit of 3.9% of GDP; the debt to GDP ratio is expected to rise to 65%. The deficit projections do not take account of the budgetary proposals of the German government, which include, on top of tax cuts of close to € 16 billion, also consolidation measures in the order of € 28 billion, roughly amounting to a net fiscal consolidation of € 12 billion. This package could not be incorporated into the forecast, because at the current stage the final 2004 budget remains unclear, as several of the government's proposals are still under discussion and need the agreement of the *Bundesrat*. The forecast therefore had to rely on the no-policy-change scenario, apart from those measures where a consensus with the opposition exists, such as the health care reform or where a *Bundesrat* agreement is not necessary, such as the pensions freeze. However, even if the final budget will push the deficit below the value included in the forecast, present government proposals, by Commission calculations, appear to be insufficient to reduce the deficit below 3% of GDP in 2004. This fact is not disputed by the German authorities and has indeed been admitted on several public occasions by the German Minister of Finance. By forsaking the target of bringing the deficit below 3% of GDP in 2004, Germany is not complying with the Article 104(7) Recommendation.

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In view of these findings, the Commission considers that the action taken by the German government in response to the Article 104(7) Recommendation has proved inadequate and recommends the Council to decide accordingly.

Recommendation for a

COUNCIL DECISION

establishing, in accordance with Article 104(8) of the EC Treaty, that the action taken by Germany in response to the recommendations made by the Council pursuant to Article 104(7) of the Treaty is proving to be inadequate

THE COUNCIL OF THE EUROPEAN UNION

Having regard to the Treaty establishing the European Community, and in particular Article 104(8) thereof,

Having regard to the recommendation from the Commission under Article 104(8),

Whereas:

(1) In stage three of Economic and Monetary Union (EMU), Member States according to Article 104 of the Treaty shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. The Stability and Growth Pact includes Council Regulation (EC) No 1467/97[1] on speeding up and clarifying the implementation of the excessive deficit procedure set out in Article 104 in order to further the prompt correction of excessive general government deficits.

(3) The Amsterdam Resolution of the European Council on the Stability and Growth Pact of 17 June 1997[2] solemnly invites all parties, namely the Member States, the Council and the Commission to implement the Treaty and the Stability and Growth Pact in a strict and timely manner.

(4) By Council Decision 2003/89/EC[3] it was decided, in accordance with Article 104(6) of the Treaty, that an excessive deficit existed in Germany.

(5) The Council, in accordance with Article 104(7) of the Treaty and Article 3(4) of Regulation (EC) No 1467/97[4], adopted on 21 January 2003 a recommendation establishing the deadline of 21 May 2003 for the German government to take measures to bring the existence of an excessive deficit to an end in 2004 at the latest; the Council recommended Germany to ensure a rigorous budgetary execution and a thorough implementation of the measures announced for 2003 amounting to 1% of GDP.

(6) On 21 January, in line with the Resolution of the European Council on the Stability and Growth Pact, Germany made public the recommendation issued pursuant Article 104(7).

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1 OJ No L 209, 2.8.1997, p.6.
2 OJ No C 236, 2.8.1997, p.1.
3 OJ L 34, 11.2.2003, p. 16.
4 OJ No L 209, 2.8.1997, p.6.

(7) According to Article 4(2) of Regulation (EC) No 1467/97, the Council, when considering whether effective action has been taken in response to its recommendations made in accordance with Article 104(7), shall base its decision on publicly announced decisions by the Government of the Member State concerned.

(8) On the basis of information available upon the expiration of the deadline of 21 May, the policies announced by the German authorities satisfied the requirement of budget consolidation measures amounting to 1 % of GDP, and the excessive deficit procedure has been held in abeyance since.

(9) In its Autumn 2003 forecast published on 29 October 2003, the Commission projects that the general government deficit in Germany in 2003 will be 4.2% of GDP and the debt-to-GDP ratio 63.8 %, which represents a deterioration in both the deficit and debt ratios vis-à-vis the situation in 2002 in nominal as well as cyclically-adjusted terms.

(10) In the Autumn 2003 forecast, the Commission projects that the excessive deficit situation will persist in 2004 and that the general government debt-to-GDP ratio will rise further. These facts were publicly confirmed by the German Minister of Finance. The German authorities have therefore not complied with the recommendations that they" *put an end to the present excessive deficit situation as rapidly as possible in accordance with Article 3(4) of Council Regulation (EC) No 1467/97*", that is to say by the end of 2004, and ensure that the rise in the debt ratio is reversed.

HAS ADOPTED THIS DECISION

Article 1

The action taken by Germany in response to the Council Recommendation of 21 January 2003 pursuant to Article 104(7) of the Treaty is proving to be inadequate to correct the excessive deficit situation within the period laid down.

Article 2

According to Article 9(2) of Council Regulation 1467/97, the period between 21 May 2003 and [25 November 2003] will not be included in the ten-months period referred to in Article 7, nor the two-months period referred to in Article 6 of the Regulation.

Article 3

This decision is addressed to the Federal Republic of Germany.

Done at Brussels,...

For the Council