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REPORT FROM THE COMMISSION

Germany

Report prepared in accordance with Article 104(3) of the Treaty

1. THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the budget balance as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn in 2008/09. Several factors are at play. First, the economic downturn has brought about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan foresaw that the stimulus should be differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to prepare a report such as the present one whenever an actual or planned deficit of a Member State exceeds the 3% of GDP reference value. This report, which represents the first step in the "excessive deficit procedure" (EDP), analyses the reasons for the breach of the reference value with due regard to the economic background and all other relevant factors. The amendments to the Stability and Growth Pact in 2005 aimed specifically at ensuring that in particular the economic and budgetary background was fully taken into account in all steps in the EDP. This means for instance that, if an "excessive deficit" is deemed to exist, adequate consideration needs to be given to the economic background and outlook when making recommendations on the pace of the correction. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

2. LEGAL BACKGROUND

This report, which assesses recent and current budgetary developments in Germany and reviews the short- and medium-term prospects in the light of overall economic conditions and policy action taken by the government, is prepared according to Article 104(3) of the Treaty.

Article 104 of the Treaty includes the provisions for an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure"[1], which is part of the Stability and Growth Pact. According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product

[1] OJ L 209, 2.8.1997, p.6. The report also takes into account the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005, available at: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

(GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

Since the start of Stage III of Economic and Monetary Union, an EDP for Germany was initiated in November 2002 by the Commission with the adoption of a report under Article 104(3) in view of a deficit of 3.8% of GDP in 2002, above the reference value of 3% of GDP[2]. In January 2003, following recommendations from the Commission, the Council decided, in accordance with Article 104(6) of the Treaty, that an excessive deficit existed in Germany and addressed a recommendation in accordance with Article 104(7) of the Treaty to Germany with a view to bringing the excessive deficit situation to an end as rapidly as possible and by 2004 at the latest. In view of the unique circumstances created by the Council conclusions of 25 November 2003 and of the ruling of the European Court of Justice of 13 July 2004[3], the year 2005 was considered to be the relevant deadline for the correction of the excessive deficit. Following a provisional notification by Germany in February 2006, actual data provided by the Commission (Eurostat) indicated that the excessive deficit had not been corrected by 2005. Therefore, based on a recommendation from the Commission, the Council in March 2006 took a decision under Article 104(9) of the Treaty giving notice to Germany to take measures in order to remedy the situation of excessive deficit as rapidly as possible and at the latest by 2007[4]. In June 2007, following an overall assessment which showed that the deficit was reduced to 1.7% of GDP in 2006, the Council decided to abrogate its decision on the existence of an excessive deficit under Article 104(12) of the Treaty.

According to the data notified by the authorities in July 2009[5], the general government deficit in Germany is planned to reach 3.9% of GDP in 2009, thus exceeding the 3% of GDP reference value, while general government gross debt would amount to 73.9% of GDP, above the 60% of GDP reference value and on a rising trend. Data notified by the authorities do not take into account the revisions resulting from the Eurostat decision on statistical recording of public interventions to support financial institutions during the financial market crisis[6].

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[2] All the relevant documents regarding the EDP procedure for Germany are available at: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

[3] Case C-27/04, *Commission v Council*, [2004] ECR I-6649.

[4] Council Decision 2006/344/EC (OJ L 126, 13.5.2006, p. 20).

[5] According to Council Regulation (EC) No 479/2009 (previously Council Regulation (EC) No 3605/93), Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. Moreover, Member states shall inform the Commission, as soon as it becomes available, of any major revision in their actual and planned governments deficit and debt figures already reported. The biannual notification of Germany can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables

[6] Eurostat decision of 15.07.2009, "The statistical recording of public interventions to support financial institutions and financial market during the financial crisis", available at:

According to the revised data[7], the German general government account was in surplus of 0.2% of GDP in 2007 and in balance in 2008. However, these figures do not include swap operations (which historically have not been significant) and therefore are not directly comparable with the notified data.

Table 1: General government deficit and debt [a b]

	2003	2004	2005	2006	2007	2008	2009		2010
							COM	DE	COM
General government balance	-4.0	-3.8	-3.3	-1.5	-0.2	-0.1	-3.9	-3.9	-5.9
General government gross debt	63.8	65.6	67.8	67.6	65.1	65.9	73.4	73.9	78.7

Note:
[a] In percent of GDP.
[b] Data notified by the German authorities do not take into account the revisions resulting from the Eurostat decision on statistical recording of public interventions to support financial institutions during the financial market crisis[8]
Source: Eurostat and Commission services' spring 2009 forecasts and data notified by the German authorities in July 2009

The planned figures for the deficit and debt in 2009 provide *prima facie* evidence on the existence of an excessive deficit in Germany in the sense of the Treaty and the Stability and Growth Pact. The Commission has therefore decided to initiate the excessive deficit procedure for Germany with the adoption of this report. Section 3 of the report examines the deficit criterion and Section 4 the debt criterion. Section 5 deals with public investment and other relevant factors. The report takes into account the Commission services' spring 2009 forecast, released on 4 May, and their evaluation of subsequent developments, in particular the Commission services' September 2009 interim forecast, released on 14 September.

3. DEFICIT CRITERION

In 2009, the planned general government deficit in the July 2009 EDP notification is 3.9% of GDP. Well in excess of 3% of GDP, the planned deficit is not close to the Treaty reference value.

The planned excess over the 3% of GDP reference value is exceptional. In particular, it does result from a severe economic downturn in the sense of the Treaty and the Stability and Growth Pact. According to the Commission services spring 2009 forecast, real GDP in Germany is projected to contract sharply in the year 2009 (-5.4% against -6% forecast by the German authorities). The recession reflects the abrupt decline in private investment and foreign trade in the export-oriented manufacturing sector as a consequence of the financial crisis and the global downturn – in particular, the worsening growth outlook of the key trading partners (euro area and EU Member States). The scale of the downturn was unexpected, with the government forecast presented in the January 2009 addendum to the December 2008 update of stability programme projecting a fall in real GDP of 2¼% for 2009

http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/FT%20-%20Eurostat%20Decision%20-%209%20July%202009%20_3_%20_final_.pdf

7 Federal Statistical Office (Destatis), Press release Nr. 311, 25.08.2009, available at: http://www.destatis.de/jetspeed/portal/cms/Sites/destatis/Internet/EN/press/pr/2009/08/PE09__311__813,templateId=renderPrint.psml

8 Eurostat decision of 15 July 2009, "The statistical recording of public interventions to support financial institutions and financial market during the financial crisis", available at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/FT%20-%20Eurostat%20Decision%20-%209%20July%202009%20_3_%20_final_.pdf

and the Commission services' January 2009 interim forecast expecting a decline of 2.3%, after 1.3% growth in 2008.

Table 2: Macroeconomic and budgetary developments [a]

	2003	2004	2005	2006	2007	2008	2009	2010
Real GDP (% change)	-0.2	1.2	0.8	3.0	2.5	1.3	-5.4	0.3
Potential GDP (% change)	1.1	0.9	0.8	0.9	0.9	1.0	0.7	0.8
Output gap (% of potential GDP)	-1.2	-0.9	-0.9	1.1	2.7	3.0	-3.2	-3.7
General government balance	-4.0	-3.8	-3.3	-1.5	-0.2	-0.1	-3.9	-5.9
Primary balance	-1.1	-1.0	-0.5	1.3	2.6	2.6	-1.0	-2.9
One-off and other temporary measures	0.0	0.1	0.1	0.0	-0.3	-0.5	0.1	-0.1
Government gross fixed capital formation	1.6	1.4	1.4	1.4	1.5	1.5	1.9	2.0
Cyclically-adjusted balance	-3.4	-3.3	-2.8	-2.1	-1.5	-1.7	-2.3	-4.0
Cyclically-adjusted primary balance	-0.5	-0.5	-0.1	0.7	1.3	1.1	0.6	-1.0
Structural balance [b]	-3.4	-3.4	-2.9	-2.1	-1.2	-1.2	-2.4	-3.9
Structural primary balance	-0.5	-0.6	-0.2	0.7	1.6	1.6	0.6	-0.9

Notes:
[a] In percent of GDP unless specified otherwise.
[b] Cyclically-adjusted balance excluding one-off and other temporary measures.
Source: Eurostat and Commission services' spring 2009 forecasts.

The planned excess over the 3% of GDP reference value is not temporary in the sense of the Treaty and the Stability and Growth Pact. The Commission services' spring 2009 forecast projects that, taking into account the measures adopted in the current year affecting the budget for 2010, the deficit would widen to 5.9% of GDP in 2010 on a no-policy change basis. Given the non-indexed nature of the tax and social benefit systems, the no-policy change assumption for 2010 is made operational, in the absence of further announced measures and taking into account that according to the current plans of the government, only part of the measures of extraordinary nature linked to the crisis will be withdrawn in 2010 (e.g. scrapping premium), by freezing average tax rates, while capital spending reflects programmed increases.

However, a subsequent evaluation led to a revision of the macroeconomic projections on which these deficit figures were based. The central assessment of the Commission services' September 2009 Interim forecast is that real GDP may fall by 5.1% in 2009 and possibly rebound somewhat more strongly in 2010[9].

In sum, the planned deficit is not close to the 3% of GDP reference value. While the planned excess over the reference value is exceptional, it is not temporary in the sense of the Treaty and the Stability and Growth Pact. This analysis suggests that the deficit criterion in the Treaty is not fulfilled.

4. DEBT CRITERION

Up from 65.9% of GDP in 2008, the general government gross debt in the July 2009 EDP notification is planned to increase to 73.9% of GDP, well above the 60% of GDP Treaty reference value. This reverses the mainly cyclical and expenditure-driven downward path from 2005 to 2007. The increase in the debt level in 2008 was mainly driven by a sizable

[9] Using a purely mechanistic application of the standard OECD elasticity of 0.5, the revised macroeconomic assessment would imply a deficit of 3¾% of GDP in 2009.

stock-flow adjustment (amounting to 2½% of GDP) resulting from the bank rescue and risk-shield operations undertaken by the German government.

According to the Commission services' spring 2009 forecast the debt-to-GDP ratio is projected to rise rapidly by 7½ percentage points to 73½% in 2009 and reach 78¾% in 2010. A significant increase in the debt ratio in 2009 would be mainly the result of debt-increasing "snowball" effects on the back of falling nominal GDP, the deterioration in the primary balance and stock-flow adjustments related to the financial market stabilisation operations (see section 5.4).

In view of these trends, the debt ratio cannot be considered as "sufficiently diminishing and approaching the reference value at a satisfactory pace" in the sense of the Treaty and the Stability and Growth Pact, suggesting that the debt criterion stipulated in Art. 104(2) of the Treaty is not fulfilled.

Table 3: Debt dynamics [a]

	2003	2004	2005	2006	2007	2008	2009	2010
Government gross debt ratio	63.8	65.6	67.8	67.6	65.1	65.9	73.4	78.7
Change in debt ratio [b] (1 = 2+3+4)	3.5	1.8	2.2	-0.2	-2.5	0.8	7.5	5.3
Contributions:								
• Primary balance (2)	1.1	1.0	0.5	-1.3	-2.6	-2.6	1.0	2.9
• "Snowball" effect (3)	*2.4*	*1.5*	*1.8*	*0.5*	*0.0*	*1.0*	*5.6*	*2.2*
of which:								
Interest expenditure	*3.0*	*2.8*	*2.8*	*2.8*	*2.8*	*2.8*	*2.9*	*3.0*
Real GDP growth	*0.1*	*-0.8*	*-0.5*	*-1.9*	*-1.6*	*-0.8*	*3.6*	*-0.2*
Inflation (GDP deflator)	*-0.7*	*-0.6*	*-0.4*	*-0.3*	*-1.2*	*-0.9*	*-0.8*	*-0.5*
• Stock-flow adjustment (4)	0.0	-0.6	-0.1	0.5	0.2	2.5	0.7	0.0

Notes:
[a] In percent of GDP.
[b] The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; D, PD, Y and SF are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth. The term in parentheses represents the "snow-ball" effect, measuring the combined effect of interest expenditure and economic growth on the debt ratio.
Source: Eurostat and Commission services' spring 2009 forecasts.

5. RELEVANT FACTORS

Article 104(3) of the Treaty provides that the Commission report "shall also take into account whether the government deficit exceeds government investment expenditure and take into account other relevant factors including the medium-term economic and budgetary position of the Member State". These factors are further clarified in Article 2(3) of Council Regulation (EC) No 1467/97, which also specifies that "any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value and which the Member State has put forward to the Commission and to the Council" need to be given due consideration.

In view of the above provisions, the following four subsections consider in turn (1) the medium-term economic position; (2) the medium-term budgetary position (including public investment); (3) other factors put forward by the Member State; and (4) other factors considered relevant by the Commission.

5.1. Medium-term economic position

Cyclical conditions and potential growth. The Commission services' spring 2009 forecast projects a contraction of German GDP by 5.4% in 2009, driven by the collapse of external demand. In 2010, a moderate recovery, with real GDP growth of 0.3%, would be induced by a rebound in world trade and the positive effects of the fiscal stimulus measures. Cyclical conditions showed a rapid widening of the positive output gap since 2006 and a sharp reversal in 2009, with the output gap turning strongly negative in 2009 and 2010. In 2009, the German economy is clearly below its potential, with an estimated output gap of -3.2 percentage points. However, a subsequent evaluation – the Commission services' September 2009 interim forecast – revealed a somewhat milder contraction of the real GDP in 2009 by 5.1% and possibly a somewhat stronger rebound in 2010. According to the latest estimates, Germany's potential output growth has fallen in 2009 to below 1%. While latest estimates of potential growth are strongly influenced by the sharp downturn in 2009, Germany needs to continue structural reforms to promote competition in services, reduce structural unemployment and improve the outcome of the education system especially for those with a migrant background.

Recent structural reforms. Within the Lisbon Strategy framework, Germany has implemented a number of measures to reform the labour market, enhance competition in network industries and to support R&D and innovation activity, in particular to promote eco-innovation. So far, R&D expenditure remained stable at around 2.5% of GDP over the period 2002-2007, of which over two-thirds comes from the business sector. The federal and the regional governments have recently agreed to enforce the 3% of GDP R&D target by setting a 10% of GDP target for joint spending on education and research in 2015 and to pursue three initiatives in parallel: the Higher Education Pact, the Pact for Research and Innovation and the Excellence Initiative. Moreover, many of the recently adopted fiscal stimulus measures to address the crisis such as infrastructure and R&D investment aim also at strengthening the growth potential.

5.2. Medium-term budgetary position

Structural deficit and fiscal consolidation in good times. Between 2006 and 2008, Germany was clearly in economic good times, as assessed in terms of sound GDP growth and a positive output gap[10]. Germany took advantage of the favourable economic situation to consolidate public finances. The structural balance improved markedly from -2.1% of GDP in 2006 to -1.2% of GDP in 2008. In 2009, however, the output gap is projected to turn sharply negative, thus the economy is expected to be in economic bad times in 2009 and 2010. The deterioration of the fiscal position in 2009 in structural terms (by 1.2 p.p.) reflects an expansionary fiscal policy stance which is projected to prevail in 2010. The role of one-off measures has been historically marginal. However, significant one-off events resulting from

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[10] The output gap figures have been revised significantly in the Commission Spring 2009 forecast as compared with the estimates in the Commission Spring 2008 forecast. While the output gap figures for the period from 2006 to 2008 have been revised upwards, with estimates for 2007 and 2008 corrected by around 2 percentage points, the new estimate for 2009 turned strongly negative from +0.8% to -3.2% of potential output. These revisions also impact the structural balance figures. According to the spring 2008 forecast, the German MTO (a balanced position in structural terms at that time) had apparently almost been achieved in 2007 (the 2007 structural balance was estimated at -0.3% of GDP, with one-off measures amounting to -0.1% of GDP). However, according to the spring 2009 forecast, the 2007 structural balance was estimated at -1.2% of GDP while one-off measures amounted to -0.3% of GDP. This would imply that the recent fiscal consolidation has not been as profound as previously considered.

the financial market stabilisation cannot be excluded. Given rising debt and falling interest rates, the primary balance is to develop in line with the headline deficit. Notwithstanding uncertainties surrounding estimates of the output gap, the budgetary position is projected to depart further from the medium-term objective, defined as close-to-balance position in structural terms, both in 2009 and in 2010.

Public investment. In the period between 2003 and 2008, public investment as share of GDP remained stable at between 1.4 and 1.6% of GDP, while the general government deficit had been falling, both in nominal and structural terms. After six consecutive years of general government and structural deficit ratios in excess of the public investment-to-GDP ratio, the situation reversed in 2007 and prevailed in 2008. However, according to the Commission services' spring 2009 forecast, the general government deficit (and the structural deficit) would exceed public investment again in 2009 and 2010.

Quality of public finances. General government expenditure has fallen from 47% of GDP in 2003 to 44% in 2008 mainly on the back of declining transfer payments due to positive labour market developments. According to the Commission services' spring 2009 forecast, the expenditure-to-GDP ratio is projected to increase significantly to over 48% in 2009 and will reach 49% in 2010. This is mostly due to additional expenditure due to automatic stabilisers, discretionary fiscal stimulus measures as well as *ad-hoc* pension adjustments and negative nominal GDP growth. In the past, Germany's medium-term budgetary framework had been weak and regular deviations from the existing rule occurred. However, the framework has been considerably strengthened recently as a result of the reform of federal fiscal relations and constitutes a crucial element of the fiscal stimulus packages. In June 2009, the *Bundestag* and the *Bundesrat* adopted a new budgetary rule that has been anchored in the German Constitution. The new rule follows the structure of the Stability and Growth Pact (SGP) in the sense that it sets a ceiling for the federal structural deficit at 0.35% of GDP from 2016 onwards with a transition period starting in 2011. The regional budgets must be structurally balanced as of 2020. Nevertheless, the German medium-term budgetary plan needs to be spelled out in more details, as the draft financial plan for 2009-2013 includes from 2011 onwards a sizeable cumulative fiscal consolidation objective ("*globale Minderausgaben*") which is neither allocated to the revenue or expenditure side (let alone to subcomponents) nor supported by measures[11]. Thus, there is a need to provide more information on the measures envisaged to support the planned consolidation, notably given the permanent nature of a large part of the fiscal stimulus measures. The government plans the modernisation of the federal system of budgeting and accounting with a stronger focus on a performance-based assessment of revenue and expenditure.

Long-term sustainability of public finances. In its opinion of 10 March 2009 on the December 2008 update of the stability programme, the Council assessed the long-term sustainability of Germany’s public finances. In particular, the Council was of the opinion that the long-term budgetary impact of ageing was close to the EU average, with pension expenditure showing a somewhat more limited increase than in many other countries, as a result of the pension reforms already enacted. The Council noticed also that the ratio of gross debt to GDP was above the Treaty reference value. Achieving high primary surpluses over the medium term would contribute to reducing the medium risks to the sustainability of

[11] German Federal Ministry of Finance, Monatsbericht des BMF, August 2009, available at: http://www.bundesfinanzministerium.de/nn_84526/DE/BMF__Startseite/Aktuelles/Monatsbericht__des__BMF/2009/08/inhalt/mobe__dokument__gesamt,templateId=raw,property=publicationFile.pdf

public finances[12]. Moreover, the Council concluded that the risks from financial sector stabilisation schemes (e.g. recapitalisation, guarantees) put in place by Germany could have a potential negative impact on the long-term sustainability of public finances, primarily via their impact on government debt, although some of the cost of the government support could be recouped in the future. The Council invited the authorities to give renewed attention to measures strengthening the long-term sustainability of public finances and ensure that the deviation form the pension adjustment formula in 2008 is reversed as envisaged.

5.3. Other factors put forward by the Member State

In a letter of 21 august 2009, the authorities of Germany listed some relevant factors in accordance with the Article 2(3) of Council Regulation (EC) No 1467/97. The Commission services' analysis already covers most of the items put forward by the authorities. The authorities emphasise that:

"In view of the difficult situation after the crises abates, a successful economic and fiscal policy in Germany would have to rely on the adequate balance between the budgetary consolidation and sustainable support of economic growth. The priority for Germany is quickest possible compliance with the deficit ceiling of the Stability and Growth Pact. The reform of the national fiscal rules in the German Constitution was a part of the fiscal stimulus packages in order to pay back resolutely the debt, to ensure the path towards balanced general government budgets and thus an intergenerationally fair fiscal policy, as well as to demonstrate clear commitment towards the rules of the Stability and Growth Pact.

The new debt rule, operational from 2011 onwards, imposes on us an ambitious framework for the future consolidation path. According to our medium-term budgetary projections which already include considerable consolidation requirements in line with the new debt rule, we assume that Germany could bring the general government deficit just below 3% only in the year 2013. The formulation of a consolidation strategy which would ensure achievement of the objectives and fulfilment of the requirements through the concrete measures is one of the most urgent tasks of the new federal government after the federal elections."

5.4. Other factors considered relevant by the Commission

In 2009 and 2010, Germany's public finances will be affected by the measures taken to address the economic crisis. In line with the European Economic Recovery Plan (EERP), Germany has adopted a wide ranging response to the crisis covering financial market, fiscal stimulus and structural measures. A sizeable fiscal stimulus (around 1¾% of GDP on average in 2009 and in 2010) includes measures that focus on income support, public and private investment, ensuring access to finance, reducing lay-offs, improving access to training and employment services, as well as instruments that support the automotive industry. The measures are broadly in line with the EERP, coming targeted and timely. A further stimulus results from the re-introduction of the commuter allowance in reaction to a decision of the Federal Constitutional Court[13]. Moreover, automatic stabilisers will work fully, implying a substantial increase in social expenditure and a significant decrease in tax revenue (estimated impact around 3% of GDP in 2009).

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[12] Since the submission of the stability programme, risks to long-term sustainability may have changed in view of the worsened economic and budgetary situation. The new assessment will be published in the upcoming report on long-term sustainability of public finances in the European Union.

[13] BVerfG; 2 BvL 1/07 vom 9.12.2008, Absatz-Nr. (1-91), available at: http://www.bverfg.de/entscheidungen/ls20081209_2bvl000107.html

Additional risks to the government accounts stem from direct implications of the financial crisis, in particular due to possible further capital injections and potential bank takeovers (with an impact on the debt, though some effect on the deficit cannot be excluded) or bank guarantees (only to affect the deficit and the debt if and when called). In particular, the risks related to the financial market stabilisation operations stem from the transactions conducted by the Financial Market Stabilisation Fund (FMSF). The fund provides guarantees of up to €400 bn (around 16% of GDP) in return for a fee and funds for capital injections and purchasing of troubled assets of up to €80 bn (around 3% of GDP). So far, the fund has granted guarantees to a number of banks amounting to total of around €130.7 bn (around 5½% of GDP) and provided capital injections of €21.9 bn (almost 1% of GDP)[14]. In addition, some of the *Länder* transferred capital and/or granted guarantees to the *Landesbanken* in difficulty. Moreover, the German government offered an unlimited guarantee for all private bank deposits.

In its Opinion on the most recent update of the stability programme, the Council welcomed a sizeable fiscal stimulus that Germany was able to introduce thanks to earlier consolidation and the achievement of a close-to-balance position in 2008. The Council emphasised that the implementation of an enhanced medium-term budgetary framework and the strong commitment at all levels of government to adhere to it will be crucial to return to fiscal consolidation once the crisis has abated. The Council considered that sufficient safety margin against breaching the 3% of GDP deficit limit would not be reached within the programme period and the outlined consolidation path was subject to considerable risks related to the uncertain macroeconomic outlook, further possible measures to stabilise the financial markets and the lack of concrete measures underpinning the consolidation. The Council therefore invited Germany to: (i) implement the 2009 and 2010 fiscal policy as planned including stimulus measures in line with the EERP and within the framework of the SGP, reverse the fiscal stimulus in order to support significant budgetary consolidation towards the MTO, starting in 2011 at the latest; (ii) to this end strengthen the institutional fiscal framework by implementing the new budgetary rule [*as currently envisaged*] in order to underpin the necessary consolidation course after 2010; (iii) give renewed attention to measures strengthening the long-term sustainability of public finances and ensure that the deviation from the pension adjustment formula in 2008 is reversed as envisaged.

6. CONCLUSIONS

The planned general government deficit in Germany, as reported in the July 2009 EDP notification, is 3.9% of GDP in 2009, above and not close to the 3% of GDP reference value. The planned excess over the reference value can be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact, but it is not temporary. This suggests that the deficit criterion in the Treaty is not fulfilled.

General government gross debt has been well above the 60% of GDP reference value since 2002 and is planned to reach 73.9% of GDP in 2009. The debt ratio cannot be considered as diminishing sufficiently and approaching the reference value at a satisfactory pace within the meaning of the Treaty and the Stability and Growth Pact. This suggests that the debt criterion in the Treaty is not fulfilled.

14 Financial Market Stabilisation Fund, Press release of 12.08.2009, available at: http://www.soffin.de/presse_archiv_12.08.09.php?sub=5

In line with the Treaty, this report has also examined “relevant factors”, which, according to the Stability and Growth Pact, can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the twin condition - that the deficit remains close to the reference value and that its excess over the reference value is temporary - is fully met. Considered on their own merit, the relevant factors in the current case present on balance a relatively favourable picture.

The existence of a severe economic downturn, with public finance implications, increases the need to undertake enhanced surveillance under the EDP.