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COMMISSION OPINION

on the existence of an excessive deficit in Germany

Application of Article 104(5) of the Treaty establishing the European Community

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

1. 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 deficit 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 brings 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 explicated that the stimulus should be timely, targeted and temporary and 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[1], although some of the costs of the government support could be recouped in the future.

2. The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. 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, and thereby ensuring long-term sustainability of public finances.

LEGAL BACKGROUND

3. Article 104 of the Treaty lays down 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"[2], which is part of the Stability and Growth Pact.

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[1] See the Eurostat decision of 15 July 2009 on the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis, Eurostat News Release No 103/2009

[2] OJ L 209, 2.8.1997, p. 6. Account is also taken of the Opinion of the Economic and Financial Committee on 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/other_pages/other_pages12638_en.htm.

4. 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 (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).

5. 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".

6. On the basis of the data notified by the German authorities in July 2009[3] and taking into account the Commission services' spring 2009 forecast, the Commission adopted a report under Article 104(3) for Germany on 7 October 2009[4].

7. Subsequently, and in accordance with Article 104(4), the Economic and Financial Committee formulated an opinion on the Commission report on 27 October 2009.

8. Article 104(5) of the Treaty requires the Commission to address an Opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. In order to reach a conclusion on whether an excessive deficit exists or may occur, the Commission considers that account should be taken of: (i) the conclusions of its report under Article 104(3) and (ii) the opinion of the Economic and Financial Committee on this report. On the basis of these elements, the Commission has established a number of considerations for Germany.

CONSIDERATIONS CONCERNING GERMANY

9. 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, which was above the reference value of 3% of GDP. 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

[3] According to Council Regulation (EC) No 479/2009, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notifications of Germany can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables.

[4] All EDP-related documents for Germany can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

conclusions of 25 November 2003 and of the ruling of the European Court of Justice of 13 July 2004[5], 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[6]. 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.

10. Between 2006 and 2008, Germany took advantage of the favourable economic situation to consolidate public finances. The general government budget swung from a deficit of almost 3½% of GDP in 2005 to a small surplus in 2007 and was in balance in 2008. Similarly, the structural deficit was reduced by 1¾ percentage points of GDP. Falling government expenditure was instrumental in this consolidation, with the reduction from almost 47% of GDP in 2005 to below 44% in 2008. Importantly, the consolidation process benefited greatly from favourable labour market developments and unexpectedly high tax revenues.

11. According to data notified by the German authorities in July 2009, the general government deficit in Germany was planned to reach 3.9% of GDP in 2009, thus exceeding the 3% of GDP reference value. The Commission report under Article 104(3) considered that the planned deficit was not close to the 3% of GDP reference value but that the planned excess over the reference value could be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact, on the basis of the information available at the time of the report. Furthermore, the planned excess over the reference value could not be considered temporary.

12. According to more recent data notified by the German authorities in October 2009, the general government deficit in Germany is now planned to reach 3.7% of GDP in 2009, thus remaining above and not close to the 3% of GDP reference value. Based on the Commission services' autumn 2009 forecast, the planned excess over the reference value still qualifies as exceptional within the meaning of the Treaty and the Stability and Growth Pact. 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 autumn 2009 forecast, real GDP in Germany is projected to contract sharply by 5% in the year 2009. Furthermore, the planned excess over the reference value cannot be considered temporary. According to the Commission services' autumn 2009 forecast taking into account the fiscal measures adopted in the current year affecting the budget for 2010 and for 2011, the deficit would widen to 5.0% in 2010 and 4.6% of GDP in 2011 on a no-policy change assumption. This assumption takes into account that, according to government plans, some part of the measures taken in line with the EERP will be maintained in 2010 but rolled back in 2011. Benefiting from the room of manoeuvre gained as a result of successful consolidation between 2005 and 2008, Germany was able to introduce an appropriate

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

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

sizeable fiscal stimulus package for 2009 and 2010 of around 1¾% of GDP on average per year, whereby a number of measures is of limited duration (e.g. infrastructure investment, reduced contribution rate to unemployment insurance). The deficit criterion in the Treaty is not fulfilled.

13. According to data notified by the German authorities in October 2009, the general government gross debt has been well above the 60% of GDP reference value since 2002 and is planned to stand at 74.2% of GDP in 2009. The Commission services' autumn 2009 forecast expects the debt-to-GDP ratio to rise rapidly by almost 9 percentage points to 73.1% in 2009 and reach 79.7% in 2011. 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. The debt criterion in the Treaty is not fulfilled.

14. In line with the provisions in the Treaty and the Stability and Growth Pact, the Commission also analysed in its report "relevant factors". According to the Stability and Growth Pact, these can only be taken into account in the steps leading to the Decision on the existence of an excessive deficit if the deficit satisfies the double condition of closeness and temporariness. In the case of Germany, the double condition is not met. Considered on their own merit, the relevant factors in the current case present on balance a relatively favourable picture.

15. The opinion of the Economic and Financial Committee in accordance with Article 104(4) of the Treaty is consistent with the assessment in the Commission report under Article 104(3).

CONCLUSION

16. The monitoring of the budgetary situation in Germany and, in particular, the examination of the compliance with the criteria laid down in Article 104(2) has led the Commission to prepare a report in accordance with Article 104(3) of the Treaty. The Commission, having taken into account its report and the opinion of the Economic and Financial Committee, is of the opinion that an excessive deficit exists in Germany.