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COMMISSION OF THE EUROPEAN COMMUNITIES

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Recommendation for a

COUNCIL RECOMMENDATION TO GERMANY

**with a view to bringing an end to the situation of an excessive government deficit -
Application of Article 104(7) of the Treaty**

(presented by the Commission)

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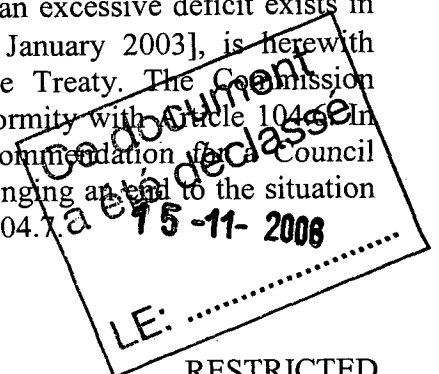
EXPLANATORY MEMORANDUM

On 13 November 2002, the Commission released its Autumn economic forecast, projecting for Germany a general government deficit of 3.8% of GDP for 2002, clearly exceeding the reference value of 3% of GDP. Based on this prima facie evidence, 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. On 18 December 2002, the Commission received the updated Stability Programme of Germany, which confirmed a government deficit figure of 3 ¼ % of GDP for 2002. The application of the excessive deficit procedure (EDP) is governed by Article 104 of the Treaty (ex 104c), Council Regulation N°1467/97 "on the speeding up and clarifying the implementation of the excessive deficit procedure", which is part of the Stability and Growth Pact. It is also affected by the political commitments enshrined in the Resolution of the Amsterdam European Council on the Stability and Growth Pact of 17 June 1997.

In an initial step of the EDP, the Commission prepared a report according to Art. 104.3 of the Treaty. That report was adopted by the Commission on 19 November. It concluded that in 2002, the general government deficit in Germany was likely to reach 3.8% of GDP, significantly exceeding the reference value of 3%. Gross government debt was projected to reach 60.9% of GDP by end-2002, also rising above the respective reference value of the Treaty (60% of GDP). The excess of the German deficit in 2002 over the reference value did not result from an unusual event outside the control of the German authorities, nor was it the result of a severe economic downturn. On developments in 2003 the report concluded that, while it was clear that the deficit would be reduced, it was not yet possible to assess whether the deficit would come to fall below the 3% of GDP reference value. Moreover, given that the debt-to-GDP ratio was projected to rise to close to 62% of GDP by the end of 2003, any slippage in budgetary execution or a deceleration in nominal GDP growth would imply an additional deterioration of the debt ratio.

Treaty Art. 104.4 states that "the Committee provided for in Article 114 (i.e. the Economic and Financial Committee) shall formulate an opinion on the report of the Commission". The Committee issued its opinion on 29 November 2002 (document EFC/ECFIN/593/02), largely subscribing to the Commission's assessment. In particular, the EFC concluded that budgetary developments in Germany in 2002 were such that both the deficit and the debt criterion referred to in Article 104(2) were not respected. Consideration of other relevant factors supported the assessment based on these criteria. While taking note of the strong commitment by the German authorities to introduce all the necessary measures to correct the situation, the EFC, following the report by the Commission, considered that there was a risk of the general government deficit exceeding the Treaty's reference value again in 2003. The Committee also underlined that gross debt was unlikely to reverse its rising trend to comply with the Treaty's reference value of 60 percent of GDP.

The Commission, having examined the relevant factors taken into account in its report and having regard to the opinion of the EFC, is of the opinion that an excessive deficit exists in Germany. This opinion, adopted by the Commission on [8 January 2003], is herewith addressed to the Council, according to Article 104.5 of the Treaty. The Commission recommends that the Council shall decide accordingly, in conformity with Article 104.6. In addition, the Commission is submitting to the Council a recommendation of a Council recommendation to be addressed to Germany with a view to bringing an end to the situation of an excessive government deficit, according to Treaty Article 104.7.



Recommendation for a

COUNCIL RECOMMENDATION TO GERMANY

**with a view to bringing an end to the situation of an excessive government deficit -
Application of Article 104(7) of the Treaty**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(7) thereof;

Having regard to the recommendation from the Commission under Article 104(7) and Article 104(13)

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

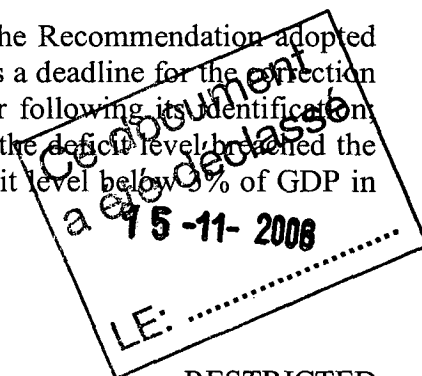
Whereas the Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation;

Whereas the Amsterdam Resolution of the European Council on the Stability and Growth Pact of 17 June 1997 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;

Whereas the Council has decided, in accordance with Article 104 (6), that an excessive deficit exists in Germany;

Whereas having decided on the existence of an excessive deficit in Germany, the Council, in accordance with Article 104(7) of the Treaty and Article 3(4) of Regulation EC 1467/97, shall adopt a Recommendation establishing a deadline of four months at the most for effective action to be taken by Germany to correct the excessive deficit position; whereas the Council takes note of the budgetary measures announced in November 2002, which aim at reducing the deficit level to 2 ¾% of GDP in 2003, as well as those planned for 2004; whereas the Council welcomes the measures announced by the German authorities but shall establish a deadline of 21 May 2003 at the latest for the German government to take measures to bring the existence of an excessive deficit to an end within the deadline established by this Council Recommendation.

Whereas Article 3(4) of Regulation EC 1467/97 requires that the Recommendation adopted by the Council in accordance with Article 104(7) also establishes a deadline for the correction of the excessive deficit, which should be completed in the year following its identification; whereas in the absence of special circumstances and given that the deficit level breached the reference value in 2002, Germany should aim to bring the deficit level below 3% of GDP in 2003;



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Whereas the German government adopted a federal budget aiming at a general government deficit of 2 ¾% for 2003; whereas this budgetary objective is based on a growth rate of real GDP of 1½% in 2003; whereas on 18 December, the German government adopted an updated Stability Programme aiming at a balanced budget in 2006 in a central scenario;

Whereas on 27 November 2002, the Commission adopted a Communication to the Council on strengthening the co-ordination of budgetary policies;

Whereas, in accordance with Article 104(12) of the Treaty, a Council decision under Article 104(6) on the existence of an excessive deficit will only be abrogated if the excessive deficit, in the view of the Council, has been corrected; whereas the Council will take into account compliance with the recommendation made under Article 104(7) when taking decisions in accordance with Article 104(12);

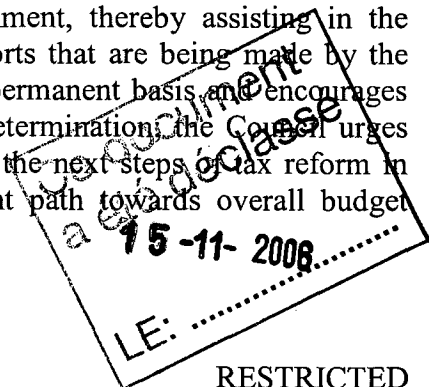
HEREBY RECOMMENDS:

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;

the German authorities to implement with resolve their budgetary plans for 2003. The Council notes that the German government, on 20 November 2002, adopted a federal budget aiming 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 in the budget for 2003; if necessary, and provided that the growth outlook is not significantly weaker than assumed in the budget, the German government to adopt and implement further budgetary measures to ensure a reduction of the government deficit in 2003 as planned, allowing a further decline in the deficit in 2004. The Council establishes a deadline of 21 May 2003 at the latest for the German government to take such measures to bring the excessive deficit to an end within the deadline established by this Council Recommendation. 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;

the German authorities to ensure that the momentum of budgetary consolidation is maintained throughout the period covered by the December 2002 update of the Stability Programme, namely through a reduction in the underlying budgetary deficit by at least 0.5% of GDP per year, which in turn requires the introduction of structural reforms. Such structural reforms should vigorously address the need to raise the growth potential of the German economy and, in this way, also be conducive to the achievement of a medium-term budgetary position of close to balance or in surplus, and to a debt ratio brought back to a declining path;

the reinforcement of the co-ordination mechanisms of budgetary policy in Germany and to secure the process of budgetary consolidation. In this regard, the Council notes with satisfaction the approval and implementation of the new §51a *Haushaltsgrundsätze-gesetz* ('law on budgetary procedures') aimed at strengthening budgetary co-ordination and fiscal discipline among the constituent sectors of general government, thereby assisting in the management of fiscal policy; the Council welcomes the efforts that are being made by the German government to reduce the government deficit on a permanent basis and encourages the German government to implement these policies with determination; the Council urges the German authorities to ensure that the implementation of the next steps of tax reform in 2004 and 2005 is compatible with a continuous adjustment path towards overall budget balance;



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This recommendation is addressed to the Federal Republic of Germany.

Done at Brussels, [...]

*For the Council
The President
[...]*

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