COMMISSION OF THE EUROPEAN COMMUNITIES

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Recommendation for a

COUNCIL RECOMMENDATION TO THE CZECH REPUBLIC

with a view to bringing an end to the situation of an excessive government deficit

(presented by the Commission)

EXPLANATORY MEMORANDUM

On 7 April 2004, the Commission published its Spring 2004 forecasts[1]. According to these forecasts, which took into consideration data reported by the Czech Republic in March 2004, the general government deficit in the Czech Republic increased from 6.4% of GDP in 2002 to 12.9% of GDP in 2003 (5.9% of GDP excluding a major one-off operation related to imputed state guarantees), thus exceeding the 3% of GDP Treaty reference value.

Based on this prima facie evidence, the Commission initiated the excessive deficit procedure for the Czech Republic on 12 May 2004, with the adoption of the report foreseen in Article 104(3) of the Treaty[2]. On 13 May 2004, the Commission received the convergence programme of the Czech Republic, which confirmed a deficit figure of 12.9% of GDP for 2003.

The application of the excessive deficit procedure (EDP) is governed by Article 104 of the Treaty and by Council Regulation (EC) No 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure", which is part of the Stability and Growth Pact[3]. Countries that joined the EU on 1 May 2004 are Member States with a derogation and are to avoid excessive deficits, but sanctions according to Article 104 (9) and (11) cannot be imposed on them."

The Commission report according to Article 104(3) of the Treaty concluded that the excess of the Czech Republic's deficit in 2003 over the 3% of GDP Treaty reference value did not result from an unusual event outside the control of the Czech authorities, nor was it the result of a severe economic downturn in the sense of the Stability and Growth Pact, as real GDP growth reached 2.9% in 2003. Concerning developments in 2004, the report concluded that the general government deficit is likely to decrease but remain above 3% of GDP. In particular, the Commission Spring 2004 forecasts are for a general government deficit of 5.9% of GDP in 2004, which is above the 5.3% of GDP projected by the Czech authorities in the convergence programme.

Based on the Commission Spring 2004 forecasts, the Commission report also concluded that the debt-to-GDP ratio, which had reached 37.6% of GDP in 2003, will remain below the 60% reference value of the Treaty in 2004. In particular, the Commission Spring 2004 forecasts projects the debt ratio to reach 40.6% of GDP in 2004, which is above the 38.4% of GDP projected by the Czech authorities in the convergence programme.

Article 104(4) of the Treaty states that "the Committee provided for in Article 114 (i.e. the Economic and Financial Committee) has to formulate an opinion on the report of the Commission". The Committee issued its opinion on 24 May 2004, subscribing to the assessment made by the Commission in its report. In particular, the Committee concluded that the budgetary situation in the Czech Republic indicated the existence of an excessive deficit under the first of the two criteria foreseen by Article 104(2) for the identification of such deficits. Consideration of other relevant factors, in particular the medium-term budgetary

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[1] The Commission Spring 2004 forecast is available at the following website: http://europa.eu.int/comm/economy_finance/publications/european_economy/2004/ee204en.pdf.

[2] The full text of this report is available at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/procedures_en.htm.

[3] OJ L 209, 2.8.1997.

position and the public investment ratio, did not change the assessment based on the criteria themselves. The Committee also considered as likely that the general government deficit would continue to exceed the Treaty reference value in 2004, and that general government gross debt would remain below the Treaty reference value of 60% of GDP but increase further to 40.6% of GDP in 2004.

The Commission, having examined the relevant factors taken into account in its report and having regard to the opinion of the Committee, is of the opinion that an excessive deficit exists in the Czech Republic. This opinion, adopted by the Commission on 24 June 2004, has been addressed to the Council, according to Article 104(5) of the Treaty. The Commission has recommended that the Council shall decide accordingly, in conformity with Article 104(6). In addition, the Commission is herewith submitting to the Council a recommendation for a Council recommendation to be addressed to the Czech Republic with a view to bringing the situation of an excessive deficit to an end, according to Article 104(7) of the Treaty. The monitoring of the implementation of action taken by the Czech Republic may demand that the Council makes further recommendations according to Article 104(7), given the non-applicability of Article 104(9) to Member States with a derogation.

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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;

Whereas:

(1) According to Article 104 of the Treaty, Member States are to 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;

(3) The Council has decided on [5 July] 2004, in accordance with Article 104(6), that an excessive deficit exists in the Czech Republic;

(4) Having decided on the existence of an excessive deficit in the Czech Republic, the Council, in accordance with Article 104(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97, is required to make at the same time recommendations to the Member State concerned with a view to bringing that situation to an end within a given period;

(5) According to Article 3(4) of Council Regulation (EC) No 1467/97, this recommendation should specify that effective action is to be taken by the Member State concerned within four months at most and that the correction of the excessive deficit should be completed in the year following its identification unless there are special circumstances. Such special circumstances are present in the case of the Czech Republic, namely because the general government deficit upon EU accession was significantly above the reference value and because of the ongoing structural shift in the economy;

(6) The existence of special circumstances authorises the Council to allow the correction of the excessive deficit in a medium-term framework. It is appropriate to consider the convergence programme submitted by the Czech Republic in May 2004, and its subsequent updates, and the Council Opinions thereof as providing the adjustment path for the correction of the excessive deficit. The convergence programme of May 2004 plans to decrease the general government deficit to 3.3% in 2007 and further mentions that the proposed path of deficit reduction indicates that the elimination of the excessive deficit would be completed by 2008, with the following intermediate

annual targets for the deficit: 5.3% of GDP in 2004, 4.7% of GDP in 2005, and 3.8% of GDP in 2006. The adjustment path is based on a macro-economic scenario which, according to the Council Opinion of [5 July] 2004 on the convergence programme, is cautious;

(7) In the view of the Council, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy.

HEREBY RECOMMENDS:

– the Czech authorities to put an end to the present excessive deficit situation as rapidly as possible;

– the Czech authorities to take action in a medium-term framework in order to bring the deficit below 3% of GDP by 2008 in a credible and sustainable manner, in accordance with the path for deficit reduction specified in the Council Opinion [of 5 July 2004] on the convergence programme submitted in May 2004;

– the Czech authorities to implement with vigour the measures envisaged in the May 2004 convergence programme, in particular a cut in the wage bill of central government and a reduction in spending of individual ministries;

– the Czech authorities to take effective action by 5 November 2004 regarding the measures envisaged to achieve the 2005 deficit target.

In addition, the Council invites the Czech authorities to:

– allocate higher-than-budgeted revenues to deficit reduction;

– introduce fiscal targeting based on medium-term expenditure ceilings and to design effective rules to reduce the risk of increasing indebtedness of regions and municipalities;

– undertake the reform of the pension and healthcare systems to improve the long-term sustainability of the public finances;

– minimise the negative budgetary impact of the operations of the Czech Consolidation Agency.

This recommendation is addressed to the Czech Republic.

Done at Brussels, [5 July] 2004.

For the Council
The President
[...]