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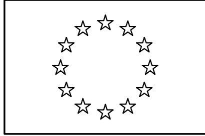

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 2.7.2008
SEC(2008) 2189 final

Recommendation for a

COUNCIL RECOMMENDATION

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

(presented by the Commission)

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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) Article 104 of the Treaty lays down an excessive deficit procedure (EDP) to ensure that Member States avoid excessive government deficits or that they correct such deficits when they occur.

(2) Pursuant to point 5 of the Protocol on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland, the obligation in Article 104(1) of the Treaty to avoid excessive general government deficits does not apply to the United Kingdom unless it moves to the third stage of economic and monetary union[1]. While in the second stage of economic and monetary union, the United Kingdom is required to endeavour to avoid excessive deficits, pursuant to Article 116(4) of the Treaty.

(3) 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.

(4) The Council has decided on 8 July 2008, in accordance with Article 104(6) of the Treaty, that an excessive deficit exists in the United Kingdom.

(5) In accordance with Article 104(7) of the Treaty and Article 3 of 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), the Council is also required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a deadline of six months at the most for effective action to be taken by the Member States concerned to correct the excessive deficit as well as a deadline for the correction of the excessive deficit, which should be

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[1] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12006E/PRO/25:EN:HTML

[2] OJ L 209, 2.8.1997, p. 6. Regulation as amended by Regulation (EC) No 1056/2005 (OJ L 174, 7.7.2005, p. 5).

completed in the year (financial year in the case of the United Kingdom) following its identification unless there are special circumstances. In deciding whether special circumstances exist, "relevant factors" as clarified in Article 2(3) of Regulation (EC) No 1467/97 should be given due consideration. Article 3(4) of Regulation (EC) No 1467/97 also specifies that in a recommendation to a Member State to correct an excessive deficit the Council should request the achievement of a minimum annual improvement in the structural balance of 0.5% of GDP as a benchmark.

(6) The Commission, in its spring 2008 forecast, projected that on the basis of unchanged policies the general government deficit would rise from 2.9% of GDP in financial year 2007/08 to 3.3% in 2008/09, and to remain at 3.3% in 2009/10. Real GDP growth, following an outturn of 3.0% in 2007, was projected to slow to 1.7% in 2008 and further to 1.6% in 2009. Against the background of the cyclical position moving from a positive output gap in 2007 to a negative one in 2008, the cyclically-adjusted deficit was projected to increase from 3.0% of GDP in 2007/08 to 3.1% of GDP in 2008/09. Thereafter, the cyclically-adjusted deficit was projected to narrow to 2.9% of GDP in 2009/10, reflecting the combined effects of discretionary measures, including the higher taxes on alcohol and motor vehicles introduced in the 2008 Budget, and a small planned fall in the government expenditure ratio. In part due to significant projected primary deficits, general government gross debt was forecast to increase from 43.2% of GDP in the 2007/08 financial year to reach 47½% of GDP in 2009/10.

(7) In the United Kingdom's 2008 Budget, the authorities presented budgetary plans showing a general government deficit of 3.2% of GDP in 2008/09, thereafter falling to 2.8% in 2009/10. The deficit figure in the latter year is lower than the corresponding figure in the Commission services' spring 2008 forecast of 3.3% of GDP, mainly due to differences in expected GDP growth in 2009/10. Subsequent to the 2008 Budget and the Commission services' spring forecast, the United Kingdom announced additional fiscal measures on 13 May 2008 relating to changes in personal income tax bands for the financial year 2008/09. The changes are expected to reduce personal income tax receipts in 2008/09 and will be financed by additional government borrowing. Other things being equal, this will lead to an increase in the 2008/09 deficit ratio forecast by the Commission services by 0.2 percentage points[3], to around 3.5% of GDP, with a similar impact on the structural deficit. Furthermore, the UK government's statement implies a risk of a deficit overshoot also in 2009/10 relative to the deficit expected in the spring forecast.

(8) In the case of the United Kingdom, the consideration of relevant factors, as clarified in Article 2(3) of Regulation (EC) No 1467/97 and examined in the Commission's report under Article 104(3), does not suggest the presence of special circumstances warranting a departure from the standard deadline for correcting the deficit. While GDP growth is expected to slow in 2008 and 2009 relative to potential growth rates, leading to the emergence of a negative output gap, GDP growth is expected to remain positive throughout the spring forecast horizon at annual rates above 1.5% in 2008 and 2009. A deadline for correction of an excessive deficit is to be set in accordance with the aforementioned Regulation, which envisages that the correction should be

[3] In the UK government's income tax announcement published on 13 May 2008, the cost of the income tax reduction was stated to amount to £2.7bn in 2008/09, which is estimated by the Commission to be equivalent to 0.2% of GDP.

completed in the year following its identification. In the case of the United Kingdom the identification took place in 2008 on the basis of a planned deficit in excess of the 3% of GDP reference value in 2008/09. Accordingly the headline deficit should be brought below the 3% of GDP reference at the latest by financial year 2009/10. For this correction to be sustainable, based on the Commission services' spring forecast, the UK authorities would have to achieve a structural improvement of at least 0.5% of GDP in 2009/10.

(9) In general, 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. A budgetary correction in the United Kingdom should be consistent with these objectives.

HEREBY RECOMMENDS:

– The United Kingdom authorities should put an end to the excessive deficit situation as soon as possible and by financial year 2009/10 at the latest, in accordance with Article 3(4) of Council Regulation (EC) No 1467/97, by bringing the general government deficit below 3% of GDP in a credible and sustainable manner.

– To this end, on the basis of the Commission services' spring 2008 forecast, the authorities should ensure a structural improvement of at least 0.5% of GDP in 2009/10.

The Council establishes the deadline of 8 January 2009 for the United Kingdom authorities to take effective action to this end.

In addition, the Council invites the United Kingdom authorities to ensure that, after the excessive deficit has been corrected, budgetary consolidation is sustained towards a medium-term budgetary objective that (i) provides an adequate safety margin with respect to the 3% of GDP deficit limit; (ii) maintains prudent debt ratios taking into account the economic and budgetary impact of ageing populations; and (iii) taking (i) and (ii) into account, allows room for budgetary manoeuvre, in particular considering the needs for public investment.

This recommendation is addressed to the United Kingdom of Great Britain and Northern Ireland

Done at Brussels,

For the Council
The President