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Commission assesses the updated Stability Programme of Germany (2000-2004)

The European Commission adopted today a recommendation to the Council of Ministers on the 2000 update of the stability programme of Germany (2000-2004). The Commission concludes that the updated programme is in line with the requirements of the Stability and Growth Pact and the Broad Economic Policy Guidelines. The updated programme foresees economic growth of 2½ % per year over the period 2000-2004. A government surplus of 1½ % of GDP is projected in 2000 due to the UMTS receipts; excluding these one-off receipts there would have been a 1% deficit. In 2001, implementation of the tax reform is likely to worsen temporarily the German budgetary position to a deficit of 1½ % of GDP. As from 2002, however, the deficit is expected to decline steadily and reach a balanced budgetary position by 2004. During the same period, the debt ratio is expected to fall from 60% of GDP to 54½ %. On the basis of the Commission's recommendation, the Ecofin Council is expected to adopt a formal opinion on the updated German stability programme on [27 November 2000].

The Commission recommendation is adopted on the initiative of Pedro Solbes, EU Commissioner for economic and monetary affairs, who commenting on the programme said: *"The Commission's assessment of the member states' stability programmes is an important element in the multilateral surveillance process. Given the continuous strengthening of economic policy co-ordination in the Union and the important spill over effects that economic policies in one member state can have for the euro-zone as a whole, the Commission will put increasing emphasis in its analysis on the degree of ambition with which member states plan to conduct their economic policies over the short and medium term. An assessment of how member states plan to tackle budgetary consolidation and implement structural reforms, on the appropriateness of the policy-mix given the current economic cycle, or on how to deal with sustainability issues like the consequences of ageing population are among the issues included in our analysis."*

The Commission's main conclusions on the German programme are the following:

- Germany submitted on 11 October its 2000 update of the stability programme. Contrary to last years programme the new update includes more detailed technical information. However, the programme could have gained in transparency by including more information on the risks to the budgetary projections stemming from important forthcoming policy decisions, e.g. the reform of public pensions.
- The **macroeconomic scenario** underlying the updated German stability programme assumes average growth of 2½ % per year over the period 2000-2004. These growth projections imply an improvement over the performance of the 1990s. They appear **attainable provided that**: (i) wage moderation continues in the years to come; (ii) long-standing rigidities in the labour and product markets are tackled with timely and determined reforms; (iii) the policy of consolidating government finances while reducing the tax burden is maintained and (iv) bureaucratic procedures to hire personnel and start new companies are simplified to take full advantage of the potential offered by the "new economy".
- Despite a slightly worse than expected outcome for 1999, the new updated SP confirms the deficit targets for the period 2000-2003 and envisages **a balanced budgetary position by 2004**. The medium-term budgetary targets of the new update remain in line with the Stability and Growth Pact requirements. Projected deficit figures lie at 1% of GDP in 2000 (surplus of 1½ % if UMTS receipts are included) and 1½ % in 2001 reflecting the temporary interruption in the improvement in the budgetary position due to the bringing forward of the tax reform. In the following years deficits will decline by steps of ½ % of GDP.
- While the budgetary position at the federal level seems to be in line with budgetary projections, developments at other levels of government risk falling behind the announced objectives. To reduce the risk of not attaining deficit targets, the Commission emphasises the importance of an **improved co-operation on government finances** between the federal government and lower levels of government in Germany.
- The Commission welcomes the **tax reform** to be implemented in 2001 which is embedded in a well articulated and comprehensive economic reform strategy. However, the resulting increase in the government deficit in that year calls for **great caution in the implementation** of the tax reforms. This is necessary to avert the risk of a more permanent deterioration of the structural deficit in Germany and to avoid that the expansionary effects of the tax reform lead to accelerating inflation, which could have negative spill-over effects for the euro area as a whole. Therefore, it seems of utmost importance to keep expenditure under strict control.
- In the event of higher than projected tax revenues these should be used for **additional deficit reductions**, thereby widening budgetary safety margins.

- The **debt ratio** in Germany will come very close to the 60% of GDP reference value already in 2000, due also to privatisations and to the use of the receipts from UMTS licences for government debt redemption. This is in line with the Eurogroup agreement on the **use of UMTS receipts** earlier this year. The debt ratio will fall further to just **under 55% by 2004**. However, as already underlined in the past, further privatisation efforts at all levels of government would be appropriate in order to counter risks to the programme's medium-term debt objectives.
- The German stability programme includes a section on forthcoming pension system reforms. While a welcome addition to last year's programme the section does not address the timing of the reforms or the potential risks to the budgetary objectives. The old-age dependency ratio will rise from 26% in 2000 to 33% in 2010 and peak at 55% in 2040. These demographic developments will put increasing pressure on the government's budgetary position in the future given the pay-as-you-go structure and the overall size of the public pension system. A **decisive lowering of the debt ratio** in Germany is therefore called for in light of the foreseeable ageing of the German society in the decades to come.

The Stability and Growth Pact, adopted by the Amsterdam European Council in June 1997, requires countries participating in the euro-zone to present stability programmes to the Council and the Commission. These programmes provide information on how countries intend to meet the objectives of the Pact and in particular the medium term goal of a budget close to balance or in surplus.

Key figures of the updated stability programme (SP) of Germany

	SP	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Real GDP growth rate (annual % change)	2000 update	1.6	3	2 ¾	2 ½	2 ½	2 ½
	1999 update	*1.4*	*2.5*	*2.5*	*2.5*	*2.5*	
General government budget balance (% of GDP)	2000 update	-1.4	-1.0*	-1 ½	-1.0	-½	0.0
	1999 update	*- 1.2*	*-1.0*	*-1.5*	*-1.0*	*-0.5*	
Government debt (% of GDP)	2000 update	61	60	58	57 ½	56 ½	54 ½
	1999 update	*61*	*61*	*60.5*	*59.5*	*58.5*	
Inflation (private consumption deflator, annual percentage change)	2000 update	0.3	1 ½	1	1 ½	1 ½	1 ½
	1999 update	*0.5*	*1-1.5*	*1.5*	*1.5*	*1.5*	

* +1½ including the proceeds from UMTS licenses