Update of the German Stability Programme
- January 2004 -

Development of the general government deficit

At the time the December 2003 update of the stability programme was submitted, negotiations on the government's reform package were still in progress in the parliamentary Mediation Committee. The compromise position reached in the Mediation Committee, which was confirmed on 17 December 2003 by the Bundesrat and the Bundestag and which took effect on 1 January 2004, differs in several respects from the reform package. An updated projection of the development of the deficit is therefore submitted.

Overall, the general government deficit in 2004 shortens from 3 ½ to 3 ¼ % of GDP (see Table 1) as compared with that in the December 2003 stability programme update. In 2005 the general government deficit is slightly up on the former estimate, whereas in 2006 and 2007 the projection is in line with the December 2003 update. The structure differs, however, as a result of shifts between political subdivisions and social insurance funds.

Table 1: Development of the deficit ratio[1]

	2002	2003	2004	2005	2006	2007
	- in % of GDP -					
Projection January 2004[1]	**-3.5**	**-4.0**	**-3 ¼**	**-2 ½**	**-2**	**-1 ½**
Memo item:						
Increase in real GDP in %	*0.2*	*-0.1*	*1 ½ to 2[2]*	*2 ¼*	*2 ¼*	*2 ¼*
Projection November 2003[1]	**-3.5**	**-4**	**-3 ½**	**-2 ½**	**-2**	**-1 ½**
Memo item:						
Increase in real GDP in %	*0.2*	*0*	*1 ½ to 2*	*2 ¼*	*2 ¼*	*2 ¼*

(1) Given the uncertainties in relation to any projection, deficits are rounded to one half of a percentage point of GDP (or to one quarter for more current figures).

(2) The German government's current projection is based on an increase of 1.7 % in real GDP.

In addition to the changes made in the reform package for 2004, the following data were processed in establishing the revised deficit trend:

- <u>Results of the National Accounts for 2003</u>

The Federal Statistical Office published non-finalized National Accounts results on 15 January 2004. These put the general government deficit for 2003 at 4.0% of GDP. At around €86 bn, the actual figure is at the lower edge of the margin on which the estimate was based. The gross domestic product for 2003 declined by 0.1 % in real terms on the year (stability programme: 0 %), whereas nominal GDP rose by 0.9 %.

- <u>Development of social insurance funds</u>

It was stated in the December 2003 update of the stability programme that the German government plans to set up a sustainability reserve for statutory pensions insurance. The relevant law makes provision for a sustainability reserve of up to 1.5 monthly disbursements by the statutory pensions insurance (around €24 bn) to be established as from 2005.

Reduction of the cyclically adjusted deficit

At the ECOFIN meeting on 25 November 2003, Germany undertook (against the background of the reform package) to reduce the cyclically adjusted deficit in 2004 by 0.6 of a percentage point and by at least 0.5 of a percentage point in 2005, or by a greater amount should this prove necessary to bring the deficit down below the 3 % ceiling. In both years this implies a reduction of the cyclically adjusted deficit by a total of 1.1 percentage points.

On the basis of the December 2003 projection a reduction of 0.8 of a percentage point will be achieved in 2004. Based on the provisional outturn, the reduction of the cyclically adjusted deficit amounts to 0.7 of a percentage point in 2004 und 0.4 of a percentage point in 2005. Taking both years together, the deficit will therefore shorten by 1.2 or, as against the outturn, by 1.1 of a percentage point. The reductions which Germany undertook to deliver will thus be achieved. As the 2005 stage of the tax reform is to be brought forward to 2004 only in part, the deficit reduction in 2004 is greater and in 2005 correspondingly smaller than expected in December. In place of the advanced tax reform stage we now have an advanced reduction of the cyclically adjusted deficit.

There is no change in the course of deficit reduction in 2006 and 2007 as against the November 2003 projection. On the basis of the selected projection, the output gap is not yet fully closed in 2007.

Reference is made in this context to the problems involved in estimating cyclically adjusted deficits as set out in the stability programme.

Table 2: Development of cyclically adjusted deficits

	2002	2003	2004	2005	2006	2007
Real GDP growth	0.2	-0.1	1 ½ to 2	2 ¼	2 ¼	2 ¼
General government fiscal balance (in % of GDP)	-3.5	-4.0	-3 ¼	-2 ½	-2	-1 ½
Cyclically adjusted fiscal balance (in % of GDP)	**-3.3**	**-3.1**	**-2 ½**	**-2**	**-1 ½**	**-1**

At the ECOFIN meeting on 25 November 2003, Germany reaffirmed its commitment to bring down the deficit to below the Maastricht reference figure in 2005. The German government will adopt additional measures, should this prove necessary in the course of the year, to ensure that this commitment is upheld. Moreover, the government will endeavour to create further scope for rapid deficit reduction, if possible as from 2005, but especially as from 2006, to ensure that the deficit develops at a faster pace in the direction of a close to balance position.

Appendix

Development of public finances[1]

(National Accounts definitions)

	ESA Code	2002	2003	2004	2005	2006	2007
		in % of GDP					
Balancing items (B.9) of levels of government							
General government	**S.13**	**-3.5**	**-4.0**	**-3 ¼**	**-2 ½**	**-2**	**-1 ½**
Central government	S.1311	-1.6	-1.9	-1¾	-1	-1	-1
State government	S.1312	-1.5	-1.5	-1 ½	-1 ½	-1	-¾
Local government	S.1313	-0.1	-0.3				
Social insurance funds	S.1314	-0.3	-0.3	-0	+0	¼	½
General government expenditure[1] (in accordance with the definition in Reg. 1500/2000)							
Intermediate consumption Social benefits in kind Compensation of employees[2]	P.2 D.63 D.1	19.7	19.8	19	19	18 ½	18
Monetary social benefits	D.62	19.4	19.7	19	18 ½	18	17 ½
Capital transfers (interest expenditure)	D.4	3.1	3.1	3	3	3	3
Subsidies	D.3	1.5	1.4	1 ½	1 ½	1	1
Gross capital formation	P.5	1.6	1.5	1 ½	1 ½	1 ½	1 ½
Other expenditure		3.2	3.5	3 ½	3 ½	3	3
Total expenditure		**48.5**	**49.0**	**48**	**46 ½**	**45 ½**	**44 ½**

	ESA Code	2002	2003	2004	2005	2006	2007
General government revenue (in accordance with the definition in Reg. 1500/2000)							
Taxes	D.2 D.5	22.6	22.6	22 ½	22 ½	22 ½	22 ½
Social contributions	D.61	18.4	18.6	18 ½	18	17 ½	17 ½
Other revenue		3.9	3.8	3 ½	3 ½	3 ½	3
Total revenue		**45.0**	**45.0**	**44 ½**	**44**	**43 ½**	**43**

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[1] Discrepancies in the totals are the result of rounding.

[2] Including other taxes on production (D.29).

Financial development of general government

Total expenditure		48.5	49.0	48	46 ½	45 ½	44 ½
Total revenue		45.0	45.0	44 ½	44	43 ½	43
Net lending/borrowing	B.9	-3.5	-4.0	-3 ¼	-2 ½	-2	-1 ½
Interest expenditure	D.4	3.1	3.1	3	3	3	3
Primary balance		-0.4	-0.9	-¼	½	1	1 ½

Development of government debt

(Maastricht definition)

	ESA Code	2002	2003	2004	2005	2006	2007
		in % of GDP					
Government debt		**60.8**	**64**	**65**	**65 ½**	**65 ½**	**65**
Primary balance		-0.4	-0.9	-¼	½	1	1 ½
Interest expenditure		3.1	3.1	3	3	3	3
Change in nominal GDP	B.1.g	1.8	0.9	2 ½	3 ½	3 ½	3 ½

Comparison of projections

of the December 2002 stability programme
and the January 2004 projection

	ESA Code	2002	2003	2004	2005	2006	2007
Change in nominal GDP in %							
January 2004 projection	B.1.g	1.8	0.9	2 ½	3 ½	3 ½	3 ½
Stability programme 2002	B.1.g	2	3 ½	3 ½	3 ½	3 ½	-
Difference			-2 ½	-1	0	0	0
Balancing item in % of GDP							
January 2004 projection	B.9	-3.5	-4.0	-3 ¼	-2 ½	-2	-1 ½
Stability programme 2002	B.9	-3 ¾	-2 ¾	-1 ½	-1	0	-
Difference			-1 ¼	-1 ¾	-1 ½	-2	-
Government debt in % of GDP							

January 2004 projection		60.8	64	65	65 ½	65 ½	65
Stability programme 2002		61	61 ½	60 ½	59 ½	57 ½	-
Difference			3 ½	4 ½	6	8	-