The economic policies as reflected in the updated programme are largely consistent with the recommendations of the Broad Economic Policy Guidelines, specifically those with budgetary implications. However, concerning the recommendations to address the challenge of ensuring the long-term sustainability of public finances in the face of population ageing, although a number of positive measures have recently been adopted, no steps to implement a major pension reform have been taken.

COUNCIL OPINION

of 9 March 2004

on the updated Stability Programme of Germany, 2003 to 2007

(2004/C 68/02)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies ([1]), and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission, after consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

On 9 March 2004 the Council examined the 2003 update of the stability programme of Germany, which covers the period 2003 to 2007. The update was submitted on 5 December 2003; responding to political developments an addendum was submitted on 29 January 2004. The updated programme largely complies with the requirements of the revised 'Code of conduct' on the content and format of stability and convergence programmes, although a greater degree of precision of the data provided would have been desirable.

On 21 January 2003, on the basis of a Commission Recommendation, the Council decided in accordance with Article 104(6) EC that an excessive deficit existed in Germany and issued a recommendation based on Article 104(7) EC recommending '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'. On 18 November 2003, the Commission adopted two recommendations on the basis of Articles 104(8) and 104(9) respectively, for the Council 1. to decide that the measures taken by Germany in response to the recommendation of 21 January 2003 had proved inadequate to bring the excessive deficit to an end; and 2. to give notice to Germany to take the necessary measures to bring the government deficit below 3 % of GDP in 2005. On 25 November 2003, the Council did not adopt the two Commission recommendations, but adopted instead a set of conclusions taking note, among other things, of the commitments made by Germany to achieve a reduction of the cyclically-adjusted deficit by 0,6 % and at least 0,5 % of GDP in 2004 and 2005, respectively, so as to ensure that the general government deficit is brought below 3 % of GDP.

The 2003 updated programme states that the German government revised its fiscal policy targets in 2003 in response to almost three years of persistent stagnation. The budgetary strategy adopted in previous updates had been to limit expenditure, flanked by structural measures to improve the functioning of the labour market, strengthen social security finances and broaden tax bases. While these objectives are confirmed in the strategy contained in the 2003 update, the aim of supporting business activity by fiscal policy has been emphasised. Fiscal consolidation over and above the proposed measures is regarded by the German authorities as putting the cyclical upturn at risk. The 2003 update reiterates that achieving a balanced budget remains central to budgetary policy but does not contain a target date.

Following the protracted stagnation over the last three years, the 2003 update projects real GDP growth to resume from an estimated – 0,1 % in 2003 to 1,7 % in 2004. In the period 2005 to 2007, growth is estimated to average 2,25 %. Employment is expected to pick up from zero growth expected in 2004 to an average growth of 0,75 % from 2005 to 2007. The GDP deflator is forecast at 1 % for 2004 and to stay at an average of 1 % from 2005 to 2007.

The growth outlook for 2004 appears realistic and is close to the Commission Autumn 2003 projection of 1,6 % for 2004. However, the update is optimistic regarding the outlook for 2005 and subsequent years, with real growth of 2,25 %, projected to continue to 2007. This is attributed to an expected rise in potential output, the underlying assumption

([1]) OJ L 209, 2.8.1997.

being that the structural reforms — some implemented in 2003 and some forthcoming in 2004 and 2005 — will have an early and substantial positive impact. By contrast, the Commission forecasts real growth of 1,8 % in 2005. Moreover, on the basis of the data provided in the addendum to the update, the commonly agreed method results in an estimate for potential growth of 1,5 % on average between 2005 and 2007 with a slight increase towards the end of the period. The scenario for the medium-term improvement in the deficit depicted in the update is thus based on an output gap closing over time and the assumption of an upward shift of potential output. However, more cautious macro-economic assumptions would have been desirable for the pursuit of a successful fiscal consolidation strategy.

For 2003, the update estimates a deficit of 4,0 % of GDP; the preliminary statistical revision of February estimated it at 3,9 % of GDP. The update targets a general government deficit of 3,25 % of GDP in 2004 and of 2,5 % for 2005. The update thus foresees the excessive deficit to be corrected by 2005 in line with the Council conclusions of 25 November 2003. In cyclically-adjusted terms, based on calculations by the Commission, the budget balance would improve by 0,7 percentage points in 2004 and by 0,4 percentage points in 2005. One-time revenue risks in 2004 might alter the relative size of the adjustment steps.

However, in the update and its addendum Germany confirms its commitment of 25 November to correct the excessive deficit by 2005 and, if necessary, to take additional measures to that effect. Indeed, under less favourable macro-economic and budgetary assumptions, the adjustment path in the programme may be insufficient to correct the excessive deficit in 2005. The achievement of this objective is surrounded by several risks: 1. GDP growth in 2005 may be below the central scenario of the updated programme. According to the sensitivity analysis performed in the update, under the assumption of a shortfall in nominal growth by half a percentage point in 2004 and in 2005, the headline deficit would lie only marginally below 3 % of GDP in 2005; 2. The achievement of the expenditure targets for 2004 and 2005 are uncertain even with growth as expected in the update's central scenario and require full implementation and efficiency of the measures introduced. Subject to risk are notably unemployment-related outlays and expenditures on pensions and health, which may turn out higher than foreseen.

The budgetary stance in the update is insufficient to ensure that the Stability and Growth Pact's medium-term objective of a budgetary position close to balance or in surplus is achieved within the programme period. For 2006 and 2007 the projections, rounded to the nearest half of a percent in the update, are for headline deficits of 2 % and 1,5 % of GDP, respectively. The improvement in the cyclically-adjusted deficit for 2006 and 2007 appears to be rather less than 0,5 percentage point annually. A budgetary position providing a sufficient safety margin to avoid breaching the 3 % of GDP deficit threshold under normal macro-economic conditions would be reached by 2006.

The debt ratio is projected to start declining only in 2007 and to remain above the Treaty 60 % of GDP reference value throughout the period covered by the programme. The evolution of the debt ratio risks being less favourable than projected, given the uncertainty about the medium-term growth rate and the actual achievement of the planned deficit reductions.

Germany has recently passed reforms that adjust the pension system and, to a lesser extent, the health sector, to demographic change. While Germany is in a considerably better position than before to meet the budgetary costs of population ageing, risks of imbalances in the long term cannot be ruled out. According to Commission quantitative indicators on the basis of current policies, demographic change would result in the debt-to-GDP ratio remaining broadly constant above 60 % of GDP over the next 20 years and increasing substantially thereafter. Securing an adequate primary surplus is essential to ensure that public finances are on sustainable footing.

The economic policies as reflected in the 2003 update are partly consistent with the recommendations in the Broad Economic Policy Guidelines, specifically those with budgetary implications. Although Germany had implemented consolidation measures of the requested size equalling 1 % of GDP, they have proved inadequate to put an end to the excessive deficit situation by 2004. Efforts at budgetary consolidation are underpinned by the ‘Agenda 2010’, an ambitious reform programme presented in 2003 with the aim of boosting growth in the medium-term. Implementation began in 2003 and is foreseen to continue over the next years. Germany should therefore ensure that budgetary consolidation continues in the years after 2005, namely through a steady reduction in the cyclically adjusted budgetary deficit by at least 0,5 percentage points of GDP per year or more if necessary to achieve the medium-term position of government finances close to balance or in surplus and bring back the debt ratio to a declining path.