COUNCIL OPINION

of 12 February 2008

on the updated stability programme of Germany, 2007-2011

(2008/C 49/04)

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:

(1) On 12 February 2008, the Council examined the updated stability programme of Germany, which covers the period 2007 to 2011.

(2) Economic growth in Germany was significantly stronger in 2006 and 2007 compared with the first half of the decade. Sustained wage restraint as well as structural reforms helped to regain competitiveness and stimulate employment growth. The marked improvement on the labour market supports the projection of a steady recovery of domestic demand, helping to balance an expected lower growth contribution from net external demand.

The speed of budgetary consolidation has been remarkable. The general government balance swung from a deficit of almost 3,5 % of GDP in 2005 to a small surplus in 2007. Similarly, the structural deficit was reduced by 2,5 percentage points of GDP between 2005 and 2007. The control of government expenditure was key in the consolidation, with a reduction from almost 47 % of GDP in 2005 to below 44 % in 2007. This owes to the consolidation measures adopted since 2005, but also to the fact that unexpectedly high tax revenues were not spent, but used for deficit reduction.

(3) The macroeconomic scenario underlying the programme envisages that real GDP growth will slow down from 2,4 % in 2007 to 2 % in 2008 and 1,5 % on average over the rest of the programme period. Judging from currently available information ([2]), this growth scenario appears plausible until 2008 and cautious thereafter. GDP growth would remain below potential in 2009-2011, yet employment is projected to be continuously increasing. Wage increases are forecast to remain moderate and would thus not lead to inflationary pressure. The trend improvement in price competitiveness observed over the last decade would, however, come to an end.

(4) For 2007, the updated programme foresees the budget in balance, broadly in line with the Commission services' autumn 2007 forecast, which projects a surplus of 0,1 % of GDP, against a target of a deficit at 1,5 % of GDP set in the previous update of the stability programme. The marked budgetary improvement over the target resulted from a base effect due to a lower-than-projected 2006 deficit, a stronger cyclical effect and a tighter fiscal stance. Budgetary implementation in 2007 was in line with the policy advice from the Council in its opinion of 27 February 2007 on the previous update of the stability programme ([3]). The Council notes that, since unexpected tax revenues were fully used for deficit reduction, budgetary implementation was also consistent with the April 2007 Eurogroup orientations for budgetary policies.

([1]) OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

([2]) The assessment takes notably into account the Commission services' autumn forecast and the Commission assessment of the Autumn 2007 implementation report of the national reform programme. Recent indicators would however point to somewhat lower growth in 2008.

([3]) OJ C 70, 27.3.2007, p. 5.

(5) The main goal of the medium-term budgetary strategy is to ensure the long-term sustainability of public finances. To achieve this, the programme proposes to continue budgetary consolidation, while improving the conditions for growth and employment. The medium-term objective (MTO), which is a balanced position in structural terms (i.e. the cyclically-adjusted balance net of one-off and other temporary measures), was broadly reached in 2007. The programme projects the structural balance to weaken somewhat in 2008 and then to improve subsequently, eventually achieving the MTO again in 2010 and a structural surplus by 2011 (calculated according to the commonly agreed methodology). The previous programme did not foresee achieving the MTO within the programme period. Moreover, economic conditions are assumed to support the move of the general government accounts into small surplus. The improvement in the primary balance follows the same pattern, with the surplus reaching 3,5 % of GDP by 2011. The envisaged consolidation is entirely expenditure-based. This would more than offset the drop in revenue due mainly to the company tax reform and the cut of unemployment insurance contribution rate in 2008. Indeed, the expenditure *ratio* would fall by 2,5 percentage points to 41,5 % of GDP by 2011, which is planned to be achieved mostly through restraint in social spending. Government gross debt, estimated to decline to 65 % of GDP in 2007, still above the 60 % of GDP Treaty reference value, is projected to decline further by 7,5 percentage points over the programme period.

(6) The risks to the budgetary projections in the programme appear balanced. The macroeconomic outlook is plausible in 2008 and cautious thereafter. Also, over the last two years, the actual budgetary situation turned out better than targeted. The programme seems to assume structural improvements from labour market reforms to be continuing over the programme period. Since no further reforms are planned, the envisaged budgetary outcome requires continued commitment to maintain firm control over expenditure. Likewise, the risks to the projected evolution of the debt *ratio* appear to be balanced.

(7) In view of this risk assessment, the budgetary stance in the programme seems sufficient to return to the MTO by 2010, as envisaged in the programme. A sufficient safety margin against breaching the 3 % of GDP deficit threshold with normal macroeconomic fluctuations would be provided throughout the programme period. However, the planned fiscal loosening by around 0,5 % of GDP implies also a divergence from the MTO only in 2008. Therefore, the fiscal policy stance reflected in the programme may not be fully in line with the Stability and Growth Pact. The Council notes that the budgetary plans for 2008 remain consistent with the April 2007 Eurogroup orientations for budgetary policies. Finally, taking into account the risks to the debt projections mentioned above, the debt *ratio* seems to be sufficiently diminishing towards the reference value over the programme period.

(8) Germany appears to be at medium risk with regard to the sustainability of public finances. The long-term budgetary impact of ageing is close to the EU average, with pension expenditure showing a somewhat more limited increase than in many other countries, as a result of the pension reforms already enacted. The recent pension reform (2007) will gradually increase the statutory retirement age to 67 years, from 2012 onwards, which should further reduce the expected increase in age-related expenditure. The budgetary position in 2007 as estimated in the programme, which is better than the starting position of the previous programme, contributes to offsetting the projected long-term budgetary impact of population ageing. However, this is not sufficient to fully cover future spending pressures. Maintaining high primary surpluses over the medium term and bringing the debt *ratio* below the Treaty reference value would contribute to reducing risks to the sustainability of public finances.

(9) While the stability programme does not specify the direct budgetary impact of the Autumn 2007 implementation report of the national reform programme, the budgetary strategies outlined in both documents seem consistent. Principal measures with a direct budgetary impact put forth in the NRP implementation report are mentioned in the stability programme, for example the company tax reform, the increase in the statutory retirement age, the social contribution rate cut, childcare facilities and the second stage of the reform of the federal system with a review of the fiscal relations between levels of government in order to ensure budgetary discipline.

(10) The budgetary strategy in the programme is broadly consistent with the country-specific broad economic policy guidelines included in the integrated guidelines and the guidelines for euro area Member States in the area of budgetary policies issued in the context of the Lisbon strategy.

(11) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the required and optional data ([1]).

The overall conclusion is that, benefiting from continued strong growth, Germany has used unexpected revenues for deficit reduction and therefore broadly achieved its medium-term objective in 2007, much earlier than envisaged in the previous programme, a result to be commended. In 2008, however, public finances could relapse into a structural deficit. The budgetary strategy foresees a gradual return to the medium-term objective thereafter, based on sustained expenditure restraint. The risks attached to the budgetary projections are neutral; while the underlying macro-economic scenario after 2008 is prudent, the envisaged budgetary outcome requires continued commitment to maintain firm control over expenditure. Germany is at medium risk as regards the sustainability of public finances.

In view of the above assessment Germany is invited to:

(i) preserve the positive results achieved in 2007 by maintaining firm control over expenditures in line with programme targets and by using unexpected extra revenues for debt reduction;

(ii) improve the long-term sustainability of public finances, by continuing to implement the growth- and employment-promoting economic reforms enacted and by underpinning the achieved fiscal consolidation with a strengthening of budgetary institutions, in particular through the ongoing revision of federal fiscal relations.

The Council also notes that such actions would be consistent with the April 2007 Eurogroup orientations for fiscal policies.

Comparison of key macroeconomic and budgetary projections

		2006	2007	2008	2009	2010	2011
Real GDP (% change)	**SP Dec 2007**	**2,9**	**2,4**	**2**	**1,5**	**1,5**	**1,5**
	COM Nov 2007	2,9	2,5	2,1	2,2	n.a.	n.a.
	SP Nov 2006	*2,3*	*1,4*	*1,75*	*1,75*	*1,75*	*n.a.*
HICP inflation (%)	**SP Dec 2007**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
	COM Nov 2007	1,8	2,2	2	1,8	n.a.	n.a.
	SP Nov 2006	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*
Output gap ([1]) (% of potential GDP)	**SP Dec 2007**	**– 0,2**	**0,7**	**1,1**	**0,8**	**0,5**	**– 0,1**
	COM Nov 2007 ([2])	– 0,5	0,3	0,6	0,9	n.a.	n.a.
	SP Nov 2006	*– 0,3*	*– 0,3*	*– 0,2*	*0*	*0*	*n.a.*
Net lending/borrowing *vis-à-vis* the rest of the world (% of GDP)	**SP Dec 2007**	**5,2**	**6,1**	**6,1**	**6,3**	**6,3**	**6,3**
	COM Nov 2007	5,2	5,8	5,8	6,1	n.a.	n.a.
	SP Nov 2006	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*

([1]) In particular, data on HICP inflation and total social transfers are not provided in the programme and not all basic assumptions underlying the macroeconomic scenario are spelled out.

		2006	2007	2008	2009	2010	2011
General government balance (% of GDP)	**SP Dec 2007**	**– 1,6**	**0**	**– 0,5**	**0**	**0,5**	**0,5**
	COM Nov 2007	– 1,6	0,1	– 0,1	0,2	n.a.	n.a.
	SP Nov 2006	*– 2,1*	*– 1,5*	*– 1,5*	*– 1*	*– 0,5*	*n.a.*
Primary balance (% of GDP)	**SP Dec 2007**	**1,2**	**3**	**2,5**	**2,5**	**3**	**3,5**
	COM Nov 2007	1,2	2,8	2,6	2,8	n.a.	n.a.
	SP Nov 2006	*0,5*	*1*	*1*	*1,5*	*2*	*n.a.*
Cyclically-adjusted balance (1) (% of GDP)	**SP Dec 2007**	**– 1,5**	**– 0,3**	**– 0,8**	**– 0,4**	**0**	**0,7**
	COM Nov 2007	– 1,3	– 0,1	– 0,4	– 0,2	n.a.	n.a.
	SP Nov 2006	*– 2,0*	*– 1,5*	*– 1,5*	*– 1,0*	*– 0,6*	*n.a.*
Structural balance (3) (% of GDP)	**SP Dec 2007**	**– 1,5**	**– 0,3**	**– 0,7**	**– 0,3**	**0**	**0,7**
	COM Nov 2007	– 1,3	0,0	– 0,4	– 0,2	n.a.	n.a.
	SP Nov 2006	*– 2*	*– 1,5*	*– 1,5*	*– 1*	*– 0,6*	*n.a.*
Government gross debt (% of GDP)	**SP Dec 2007**	**67,5**	**65**	**63**	**61,5**	**59,5**	**57,5**
	COM Nov 2007	67,5	64,7	62,6	60,3	n.a.	n.a.
	SP Nov 2006	*68*	*67*	*66,5*	*65,5*	*64,5*	*n.a.*

Notes:

(1) Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.

(2) Based on estimated potential growth of 1,2 %, 1,6 %, 1,8 % and 1,9 % respectively in the period 2006-2009.

(3) Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0,1 % of GDP in 2008 and 2009; all deficit-increasing, according to the most recent programme; and 0,1 % of GDP in 2007 and 2009; all deficit-increasing, according to the Commission services' autumn forecast.

Sources:

Stability programme (SP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations.