I

(Resolutions, recommendations and opinions)

OPINIONS

COUNCIL

COUNCIL OPINION

of 10 March 2009

on the updated stability programme of Germany, 2008-2012

(2009/C 66/01)

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 10 March 2009, the Council examined the updated stability programme of Germany, which covers the period 2008 to 2012.

(2) As a heavily export-oriented economy strongly specialised in investment goods, Germany is severely hit by the global recession. Real GDP growth decelerated sharply in 2008 on the back of lower export growth. A number of financial institutions, including the *Landesbanken*, had to bear substantial losses from the financial crisis. The direct impact of the financial crisis on the economy was, however, limited by overall sound corporate balance sheets, strong price competitiveness and the fact that Germany is not experiencing a correction in the housing market. Restoring confidence in the financial sector, ensuring access to corporate financing, facilitating adjustments in the labour market to deal with rising unemployment and strengthening domestic demand are key near-term challenges. Benefiting from successful fiscal consolidation the general government budget was close to balance in 2007 and 2008. Against this background, Germany adopted two fiscal stimulus packages in autumn 2008 and January 2009 which aim at bolstering private consumption, boosting private and public investment, ensuring access to finance, avoiding lay-offs, improving access to training, and which include measures that support the motor car industry. Revenue shortfalls and higher expenditure implied by these measures as well as by automatic stabilisers will lead to a deficit in public finances. Moreover, contingent liabilities in the context of large-scale bank rescue operations pose additional risks to the budget. An effective budgetary framework will help to support fiscal consolidation once the crisis abates.

([1]) OJ L 209, 2.8.1997, 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

(3) The macro-economic scenario underlying the January addendum envisages that real GDP growth will fall from 1,25 % in 2008 to – 2,25 % in 2009 before recovering to 1,25 % from 2010 onward. Assessed against currently available information ([1]), this scenario appears to be based on plausible growth assumptions until 2009 and somewhat favourable assumptions from 2010. In particular the expected recovery of private consumption in 2010 may prove more subdued, should the economic crisis lead to a sharper decrease in employment. The macro-economic projections take into account the stimulus measures adopted, but do not quantify their expected economic impact. The programme's projections for inflation appear realistic.

(4) For 2008, the general government deficit is estimated at 0,1 % of GDP in the Commission services' January 2009 interim forecast, against a target of 0,5 % of GDP set in the December 2007 update of the programme. This better-than-expected outturn was owed to substantial revenue windfalls which occurred despite the corporate tax reform and a cut in social contribution rates. Higher direct tax revenues reflect stronger wage and employment growth and related fiscal drag effects. Part of the additional revenue was used to finance the reduction in social contribution rates and extra spending. Expenditure was 0,25 % of GDP higher than planned mainly due to one-off measures in connection with the bank rescue operations and higher outlays for retirement benefits as a result of *ad hoc* changes in the pension adjustment formula.

(5) The target for the general government balance in 2009 is a deficit of 3 % of GDP. This is in line with the Commission services interim forecast. The widening of the deficit reflects tax revenue losses and higher expenditure due to automatic stabilisers (around 1,5 % of GDP) and stimulus measures taken in response to the crisis (around 1,5 % of GDP). The expenditure-to-GDP ratio is expected to increase by 2,5 percentage points, while the revenue-to-GDP ratio is projected to fall by 0,5 percentage point. The structural deficit (as recalculated by the Commission's services on the basis of the information provided in the programme) is estimated to widen by around 1,5 percentage points.

(6) The medium-term budgetary objective (MTO) is to maintain a general government budget close to balance in structural terms (cyclically-adjusted net of one-off and other temporary measures). According to the programme, this implies a structural deficit of 0-0,5 % of GDP. The MTO is not expected to be reached within the programme period. However, budgetary consolidation is resumed after the deficit has peaked at 4 % of GDP, above the Treaty reference value, in 2010, to 3 % of GDP in 2011 and 2,5 % in 2012. The projections in the January addendum are based on a no-policy-change scenario and imply a mainly expenditure-based consolidation after 2010. The revenue-to-GDP ratio is expected to fall by 1,5 percentage points over 2008-2010 to 42,5 %, remain at that level in 2011 and to rebound in 2012 by 0,5 percentage point. The expenditure-to-GDP ratio will increase by 2,5 percentage points between 2008 and 2010, and is to fall thereafter by 1 percentage point.

The revenue and expenditure developments in 2010 are mainly driven by the fiscal stimulus measures in response to the crisis. Measures underpinning the consolidation process after 2010 are not specified. Expiry of certain stimulus measures and the debt repayment fund could support the consolidation efforts. Rising deficits, lower nominal GDP growth and the stock-flow adjustments in 2008 reflecting primarily bank rescue operations contribute to an increase in the debt-to-GDP ratio by 7 percentage points over the programme period up to 72,5 % of GDP.

(7) The budgetary outcomes are subject to downside risks, in particular from 2010 onwards. First, the underlying macro-economic assumptions are subject to uncertainty as to the duration, extent and impact of the financial crisis. They appear to be somewhat favourable especially for 2010 and thereafter, when a swift recovery is projected to bring real GDP growth back to potential. Second, a risk to the projection is the potential lack of sufficient commitment at all levels of government to exert expenditure discipline. Third, considerable risks stem from lack of information on the measures envisaged to support the planned consolidation after 2010, notably given the permanent nature of a large part of the fiscal stimulus measures. In view of the negative risks to the deficit targets, the evolution of the debt ratio may also prove less benign than envisaged. Additional risks to the

([1]) The assessment notably takes into account the Commission services' January 2009 forecast, but also other information that has become available since then.

government accounts relate to direct implications of the financial crisis, in particular to possible further capital injections and potential bank takeovers (with an impact on the debt, though some effect on the deficit cannot be excluded) or bank guarantees (only to affect the deficit and the debt if and when called).

(8) 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. While the budgetary position in 2008 as estimated in the addendum would have contributed to partly offsetting the long-term budgetary impact of population ageing, the contrary would result if the budgetary projections materialise. Moreover, the current ratio of gross debt to GDP is above the Treaty reference value. Achieving high primary surpluses over the medium term would contribute to reducing the medium risks to the sustainability of public finances. The above-mentioned risks from financial sector stabilisation schemes (e.g. recapitalisation, guarantees) put in place by Germany could have a potential negative impact on the long-term sustainability of public finances, primarily via their impact on government debt, although some of the cost of the government support could be recouped in the future.

(9) Despite the overall sound quality of public finances and fiscal rules, there is still room for improvements of Germany's institutional budgetary framework. The Council welcomes the progress towards establishing a new budgetary rule providing for a limit of 0,35 % of GDP for the federal structural deficit in normal times and structurally balanced *Länder* budgets. The rule is to be anchored in the German Constitution still during the current legislation period and become operational by 2011 with transition periods for the federal government until 2015 and for the Länder until 2019. Furthermore, the government plans an overhaul of the federal budgeting and accounting system with a stronger focus on a performance-based assessment of revenues and expenditures.

(10) With a view to stabilising the financial sector, the German authorities established a Financial Market Stabilisation Fund operational until end-2009 to provide capital (EUR 80 billion, around 3 % of GDP) and credit guarantees (EUR 400 billion, around 16 % of GDP). Already in 2007 and 2008 the German government at the federal and regional level was involved in large-scale bank rescue operations, providing capital and guarantees. Moreover, in 2008 the German government offered an unlimited guarantee for all private bank deposits. Further initiatives to alleviate bank balance sheets from troubled assets are under discussion. Resulting contingent liabilities from these rescue measures pose additional risks to the budget.

(11) In line with the EERP agreed in December by the European Council, Germany decided on a sizeable fiscal stimulus for 2009 and 2010 (around 3,5 % of GDP over two years) which is deemed to be an adequate response to the economic downturn. The measures focus on income support, private and public investment, avoiding lay-offs and improving training, support to credit-constrained companies and the automotive industry. They are broadly in line with the EERP, coming targeted and timely, even though the stimulus is somewhat back-loaded. However, while some of the measures are of temporary nature, a substantial part of them will be permanent. Thus, the full reversibility of the measures adopted in response to the crisis is not ensured. However, the envisaged debt repayment schedule and the new budgetary rule will aid the necessary fiscal consolidation process once the crisis recedes. The recovery will be supported by structural measures such as innovation support for the private sector, improved employment services and better broadband access within the framework of the planned Broadband Strategy. These measures are related to the medium-term reform agenda and the country-specific recommendations proposed by the Commission on 28 January 2009 under the Lisbon Strategy for Growth and Jobs. Moreover, temporary changes in the public procurement procedures aim at accelerating infrastructure investment.

(12) In response to the economic downturn, the overall fiscal stance in 2009 and 2010 is expansionary. In the latter year, the deficit is expected to exceed the reference value. For 2011, the programme targets a substantial structural improvement (by 1 percentage point) and a further, albeit smaller step for 2012. While the pace of deficit reduction is broadly in line with the Stability and Growth Pact, a sufficient safety margin against breaching the 3 % of GDP deficit limit would not be reached within

the programme period and the outlined consolidation path is subject to considerable risks. Finally, the debt ratio is increasing over the programme period, reflecting the expansionary stance in 2009 and 2010 and financial transactions related to the bank rescue operations undertaken.

(13) 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 earlier consolidation and the achievement of a close-to-balance position in 2008, Germany was able to introduce a sizeable fiscal stimulus. This is welcome as it is commensurate with the scale of the economic downturn. Given the sharp deterioration in the global economic environment and distress in the financial sector, the budgetary strategy is subject to downside risks. Full reversibility of the short-term measures adopted in response to the crisis is however currently not ensured. Hence, the implementation of an enhanced medium-term budgetary framework as currently envisaged and the strong commitment at all levels of government to adhere to it will be crucial to return to fiscal consolidation once the crisis has abated. Given increasing public debt, *ad hoc* changes to the pension adjustment formula and uncertainty as to the impact of the health-care reform, preserving the achievements made to improve long-term sustainability is critical.

In view of the above assessment, Germany is invited to:

(i) implement the 2009 and 2010 fiscal policy as planned including stimulus measures in line with the EERP and within the framework of the SGP, reverse the fiscal stimulus in order to support significant budgetary consolidation towards the MTO, starting in 2011 at the latest;

(ii) to this end strengthen the institutional fiscal framework by implementing the new budgetary rule as currently envisaged in order to underpin the necessary consolidation course after 2010;

(iii) give renewed attention to measures strengthening the long-term sustainability of public finances and ensure that the deviation from the pension adjustment formula in 2008 is reversed as envisaged.

Comparison of key macro-economic and budgetary projections

		2007	2008	2009	2010	2011	2012
Real GDP (% change)	SP Dec 2008	2,5	1,3	− 2,25	1,25	1,25	1,25
	COM Jan 2009	2,5	1,3	− 2,3	0,7	n.a.	n.a.
	SP Nov 2007	*2,4*	*2,0*	*1,5*	*1,5*	*1,5*	*n.a.*
HICP inflation (%)	SP Dec 2008	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	COM Jan 2009	2,3	2,8	0,8	1,4	n.a.	n.a.
	SP Nov 2007	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*
Output gap ([1]) (% of potential GDP)	SP Dec 2008	2,0	2,2	− 0,9	− 0,7	− 0,7	− 1,0
	COM Jan 2009 ([2])	2,2	2,3	− 1,0	− 1,2	n.a.	n.a.
	SP Nov 2007	*0,7*	*1,1*	*0,8*	*0,5*	*− 0,1*	*n.a.*
Net lending/borrowing *vis-à-vis* the rest of the world (% of GDP)	SP Dec 2008	7,6	7,1	7,0	7	7	7
	COM Jan 2009	7,6	7,1	5,2	5,4	n.a.	n.a.
	SP Nov 2007	*6,1*	*6,1*	*6,3*	*6,3*	*6,3*	*n.a.*

([1]) In particular, data on HICP inflation, the breakdown of tax revenue and of government expenditure into intermediate consumption, social transfers in kind and compensation of employees are not provided in the programme and not all basic assumptions underlying the macro-economic scenario are spelled out.

		2007	2008	2009	2010	2011	2012
General government revenue (% of GDP)	SP Dec 2008	44,0	44	43,5	42,5	42,5	43
	COM Jan 2009	43,9	43,7	43,5	42,3	n.a.	n.a.
	SP Nov 2007	*44*	*43*	*43*	*42,5*	*42*	*n.a.*
General government expenditure (% of GDP)	SP Dec 2008	44,2	44	46,5	46,5	45,5	45,5
	COM Jan 2009	44,1	43,8	46,4	46,4	n.a.	n.a.
	SP Nov 2007	*44*	*43,5*	*43*	*42*	*41,5*	*n.a.*
General government balance (% of GDP)	SP Dec 2008	− 0,2	− 0	− 3	− 4	− 3	− 2,5
	COM Jan 2009	− 0,2	− 0,1	− 2,9	− 4,2	n.a.	n.a.
	SP Nov 2007	*0*	*− 0,5*	*0*	*0,5*	*0,5*	*n.a.*
Primary balance (% of GDP)	SP Dec 2008	2,6	2,5	0	− 1	0	,5
	COM Jan 2009	2,6	2,6	− 0,1	− 1,3	n.a.	n.a.
	SP Nov 2007	*3*	*2,5*	*2,5*	*3*	*3,5*	*n.a.*
Cyclically-adjusted balance ([1]) (% of GDP)	SP Dec 2008	− 1,2	− 1,2	− 2,4	− 3,5	− 2,4	− 2,1
	COM Jan 2009	− 1,3	− 1,3	− 2,4	− 3,6	n.a.	n.a.
	SP Nov 2007	*− 0,3*	*− 0,8*	*− 0,4*	*0,0*	*0,7*	*n.a.*
Structural balance ([3]) (% of GDP)	SP Dec 2008	− 0,9	− 0.8	− 2,5	− 3,4	− 2,4	− 2,1
	COM Jan 2009	− 1,0	− 0,9	− 2,4	− 3,4	n.a.	n.a.
	SP Nov 2007	*− 0,3*	*− 0,7*	*− 0,3*	*0*	*0,7*	*n.a.*
Government gross debt (% of GDP)	SP Dec 2008	65,1	65,5	68,5	70,5	71,5	72,5
	COM Jan 2009	65,1	65,6	69,6	72,3	n.a.	n.a.
	SP Nov 2007	*65*	*63*	*− 61,5*	*− 59,5*	*− 57,5*	*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 1,1 %, 1,2 %, 0,9 % and 1,0 % respectively in the period 2007-2010.

([3]) Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0,3 % of GDP in 2007 and 0,5 % of GDP in 2008 all deficit-increasing according to the most recent programme and 0,3 % of GDP in 2007, 0,3 % of GDP in 2008 and 0,1 % of GDP in 2010 all deficit-increasing in the Commission services' January interim forecast.

Source:

Stability programme (SP); Commission services' January 2009 interim forecasts (COM); Commission services' calculations.