COUNCIL OF
THE EUROPEAN UNION

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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject:	COUNCIL RECOMMENDATION with a view to bringing an end to the situation of an excessive government deficit

COUNCIL RECOMMENDATION

of

with a view to bringing an end to the situation of an excessive government deficit

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(7) thereof,

Having regard to the recommendation from the Commission, Whereas:

(1) Article 104 of the Treaty lays down an excessive deficit procedure (EDP) to ensure that Member States avoid excessive government deficits or that they correct such deficits when they occur.

(2) Pursuant to point 5 of the Protocol on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland, the obligation in Article 104(1) of the Treaty to avoid excessive general government deficits does not apply to the United Kingdom unless it moves to the third stage of economic and monetary union. While in the second stage, the United Kingdom is required to endeavour to avoid excessive government deficits, pursuant to Article 116(4) of the Treaty.

(3) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(4) The Council decided on 24 January 2006, in accordance with Article 104(6) of the Treaty, that an excessive deficit exists in the United Kingdom.

(5) In accordance with Article 104(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[1], which is part of the Stability and Growth Pact, the Council is also required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a deadline of six months at the most for effective action to be taken by the Member States concerned to correct the excessive deficit as well as a deadline for the correction of the excessive deficit, which should be completed in the year (budgetary year in the case of the United Kingdom) following its identification unless there are special circumstances. In deciding whether special circumstances exist, "relevant factors" as clarified in Article 2(3) of Regulation (EC) No 1467/97 should be given due consideration. Article 3(4) of Regulation (EC) No 1467/97 also specifies that in a recommendation to a Member State to correct an excessive deficit the Council should request the achievement of a minimum annual improvement in the structural balance of at least 0,5% of GDP as a benchmark.

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1 OJ L 209, 2.8.1997, p. 6. Regulation as amended by Regulation (EC) No 1056/2005 (OJ L 174, 7.7.2005, p. 5).

(6) The Commission, in its autumn 2005 forecasts, projected that on the basis of unchanged policies the general government deficit would rise from 3,2% of GDP in the financial year 2004/05 to 3,4% in 2005/06, before declining to 3,2% in 2006/07 and 3,0% in 2007/08. Real GDP growth, following an outturn of 3,2% in 2004, was projected to slow to 1,6% in 2005 before recovering to 2,3% in 2006 and 2,8% in 2007. Given the cyclical position evolving from a positive output gap in 2004 to a negative one in 2005, the cyclically adjusted deficit was projected to decline from a trough of 3½% of GDP in 2004 to just over 3% of GDP in 2005. Thereafter, given a widening of the negative output gap in 2006, the cyclically adjusted deficit was projected to continue to narrow progressively, reaching just over 2½% of GDP in 2007. As a consequence of the existence of significant actual and projected primary deficits, general government gross debt was projected to increase from 40,8% of GDP in the 2004/05 financial year to reach around 44½% of GDP in 2007/08, which is nonetheless well below the 60% of GDP reference value, meaning that the Treaty requirement concerning the debt criterion is respected by a large margin.

(7) After the Commission services' autumn forecasts had been published, the United Kingdom announced policy decisions in the Pre-Budget Report presented to Parliament on 5 December 2005. In net terms, the United Kingdom authorities' costings of these measures, compared with the baseline of announced policy (as taken into account in the autumn forecasts), represent an easing of policy by 0,1 pp of GDP in the current financial year and a tightening of policy by 0,1 pp of GDP in 2006/07. Compared to an unchanged policy scenario, the Pre-Budget Report foresees a tightening of 0,2 pp of GDP in 2007/08 which is expected to be permanent. In the Pre-Budget Report, the UK authorities expect the deficit to be below 3% in 2006/07, and fall to 2,4% in 2007/08. Taking into consideration these measures, which are all structural, the Commission's assessment nevertheless remains that the deficit through to 2006/07 is still expected to exceed 3% of GDP, at around 3,1% of GDP in 2006/07.

(8) In the case of the United Kingdom, the consideration of relevant factors, as clarified in Article 2(3) of Regulation (EC) No 1467/97 and examined in the Commission's report under Article 104(3) of the Treaty as being on their own merit relatively favourable, does not suggest the existence of special circumstances warranting a departure from the standard deadline for correcting the deficit. In particular, while the negative output gap is expected to widen between 2005 and 2006 by approaching ½% percentage point, output in the Commission services' autumn forecasts was projected to be strengthening from late 2005, with approximately trend-level growth from 2006. The measures announced in the Pre-Budget Report do not materially affect this growth profile. The cyclically adjusted deficit in the Commission services' autumn forecasts was assessed to improve by 0,3% points of GDP between 2005 and 2006; this improvement can be expected to be around 0,4% points of GDP, after taking account of the Pre-Budget Report measures. In 2004/05, general government gross fixed capital formation continued to increase, rising to 1,8% of GDP, and in the UK Pre-Budget report is set to reach 2,2% in 2006/07 and 2,3% in 2007/08. Therefore, on the basis of announced policies, output growth is projected to remain reasonably strong in a situation of moderate improvement of the cyclically adjusted deficit, but with the actual deficit remaining slightly above the reference value. In the Pre-Budget Report, based on their own calculations, the UK authorities expect the cyclically adjusted deficit to fall by 0,5% points of GDP between 2005/06 and 2006/07, following a 0,7% point reduction between 2004/05 and 2005/06. According to the Commission forecast, the application of the benchmark annual improvement of at least 0,5% of GDP requires a further slight degree of fiscal effort. Accordingly, since overall growth performance in the United Kingdom remains reasonably satisfactory and the structural improvement in the government balance required to put to an end its excessive deficit is modest, this should be achieved at the latest by the financial year 2006/07.

(9) In general, in the view of the Council, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy. A budgetary consolidation in the United Kingdom should be consistent with these objectives,

HEREBY RECOMMENDS THAT:

– The United Kingdom authorities should put an end to the present excessive deficit situation as soon as possible and by the financial year 2006/07 at the latest, in accordance with Article 3(4) of Regulation (EC) No 1467/97.

– The United Kingdom authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner and to this end ensure an improvement of the structural balance by at least 0,5 percentage points of GDP between the 2005/06 and 2006/07 financial years.

The Council establishes the deadline of 24 July 2006 for the United Kingdom authorities to take effective action to this end.

In addition, the Council invites the United Kingdom authorities to ensure that, after the excessive deficit has been corrected, budgetary consolidation is sustained towards a medium-term budgetary objective that (i) provides a safety margin with respect to the 3% of GDP deficit limit; (ii) maintains prudent debt ratios taking into account the economic and budgetary impact of ageing populations; and (iii) taking (i) and (ii) into account, allows room for budgetary manoeuvre, in particular considering the needs for public investment.

This Recommendation is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels,

For the Council
The President