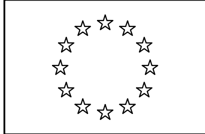

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Assessment of budgetary implementation in the context of the ongoing Excessive Deficit Procedures after the Commission Services' 2011 Autumn Forecast

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1. OVERVIEW

The importance of sound public finances as a precondition for sustained economic growth and job creation has been underlined since the beginning of the post-2007 financial and economic crisis. Insufficiently prudent fiscal policies combined with wider macroeconomic imbalances made several Members States vulnerable to the financial market turbulence experienced since 2008. The EU coordination and surveillance mechanisms in place were not strong and comprehensive enough to prevent individual Members States from drifting into vulnerable positions and affecting other countries.

In response to this shortcoming, the Commission proposed in September 2010 a comprehensive legislative package to strengthen fiscal surveillance and to expand policy surveillance to cover macroeconomic imbalances. The legislative package, the so-called "Six Pack", was finally approved by the Council and the European Parliament in November 2011 and entered into force on 13 December 2011. The package represents an important reinforcement of the tools of economic and fiscal surveillance.

As a central part of this package, the Stability and Growth Pact has been strengthened, both in its preventive and in its corrective arm, the excessive deficit procedure (EDP). In the current situation, where 23 Members States are in the EDP, the new stipulations of the corrective arm are of particular importance. For euro-area Member States, financial sanctions are now applied as a rule in case national authorities do not take effective action to comply with the recommendations addressed to them by the Council under Article 126(7) of the Treaty. In particular, Regulation (EU) No 1173/2011 of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area[1] requires the Commission to recommend to the Council to impose a fine on a euro-area Member State that has failed to take effective action to correct an excessive deficit in accordance with Article 126(8) of the Treaty. This new rule applies to any euro-area Member State to which a Council decision under Article 126(8) of the Treaty is addressed after the entry into force of the Six Pack.

A strict application of the reinforced rules on fiscal discipline is decisive for the credibility of the euro as a stable and strong currency and an indispensable part of the resolution of the sovereign debt crisis. The Commission has indicated early on that it will apply the new tools provided by the legislative package rigorously from the beginning. A comprehensive assessment of the budgetary implementation in the context of the ongoing EDPs was carried out on the basis of the Commission services' 2011 Autumn Forecast, published on 10 November 2011. Of the 23 Member States currently in EDP, five are or were benefiting from a financial assistance programme[2]. While the budgetary developments in programme

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1 OJ L 306, 23.11.2011, p. 5.

2 Greece, Ireland, Portugal, Romania and Latvia. The Balance of Payment (BoP) programme for Latvia expires on 20 January 2012.

countries are to be reviewed against the provisions of the respective programme documents, the Commission services' assessment of state of implementation of the respective Council recommendations under Article 126(7) by the 18 non-programme Member States showed that in a majority of countries policies pointed to good progress towards a timely and sustainable correction of the excessive government deficit.

At the same time however, the assessment also showed that a timely and sustainable correction was clearly at risk in some Member States, specifically, in Belgium, Cyprus, Hungary, Malta and Poland, where the deadline for correcting the excessive deficit was imminent or close, that is 2011 or 2012. Importantly, in four out of these five countries - Hungary, Poland, Belgium and Cyprus - the fiscal effort as adopted until the cut-off date of the Commission services' 2011 Autumn Forecast (24 October 2011) was assessed to fall short of the effort recommended by the Council, unless further measures were taken. In the case of Malta and Hungary, where the deadline for correcting the excessive government deficit was 2011, it was found that unless further measures were taken to keep the government deficit below 3% of GDP over the forecast period the general government deficit would not be corrected in a sustainable manner, as requested by the Council.

In view of this assessment and the imminent entry into force of the Six Pack, Vice-President Olli Rehn, responsible for economic and monetary affairs and the Euro, on 11 November 2011 addressed letters to the Member States concerned. These Member States were called upon to treat as a matter of urgency the adoption of a 2012 budget and/or additional measures that ensure a timely and sustainable correction of the excessive deficit. In the absence of adopted corrective measures, further steps under the EDP, with the possibility of prompting sanctions, would become unavoidable.

The call for additional measures also echoed the Council conclusions on fiscal policies of 4 October 2011, which called on Member States to fully implement their commitments under the Stability and Growth Pact, specifying that countries with significant adjustment gaps under the EDP should close these gaps with specific measures at the latest in their 2012 budgets.

Since mid-November all five Member States with a deadline for correction in 2011 and 2012, and where according to the Commission services' 2011 Autumn Forecast the timely and sustainable correction of the excessive deficit was considered to be at risk, have adopted and announced measures. In most cases, these additional measures are considered sufficient to bring the correction of the excessive deficit back on track, in line with the Council’s recommendations. This is the case in Belgium, Cyprus, Malta and Poland. However, while additional efforts have been made also in Hungary, the Commission's assessment shows that these efforts are still not sufficient to ensure adequate progress towards a sustainable correction of the excessive deficit.

This communication outlines the key elements of the Commission's assessment. In particular, on the basis of the Commission services' 2011 Autumn Forecast and taking into account subsequent budgetary initiatives adopted by these five Member States until 9 January 2012, it presents the Commission’s latest view on the budgetary implementation in the context of the EDP in these Member States. A more detailed and comprehensive assessment can be found in the five country-specific Commission Staff Working Papers published together with this communication.

In light of its assessment, the Commission recommends to the Council to step up the EDP for Hungary. To that end, the Commission, in parallel to this Communication, adopts a recommendation for a Council decision under Article 126(8) of the Treaty establishing that no effective action has been taken in response to the Council recommendation under Article 126(7) of the Treaty with a view to bringing an end to the situation of an excessive government deficit.

At a later stage, subject to the Council decision that no effective action has been taken, the Commission will, in line with the provisions of the Stability and Growth Pact (SGP), adopt for Hungary – a Member State whose currency is not the euro – a recommendation for a new Council recommendation under Article 126(7) of the Treaty with a view to bringing an end to the situation of an excessive government deficit. This recommendation will be adopted by the Council within two months of the Council decision establishing that no effective action has been taken. Following the Council decision that no effective action has been taken, the Commission may in line with the provisions of Council Regulation (EC) No 1084/2006, also consider issuing a proposal to the Council on the suspension of Cohesion fund commitments to Hungary.

The Commission services' 2011 Autumn Forecast also showed budgetary adjustment gaps for some Member States where the deadline for correcting the excessive government deficit is 2013. For these Member States, it is a matter of urgency to address these gaps in particular when preparing their budgetary plans to be submitted in the context of the 2012 European Semester in the updated Stability or Convergence Programmes.

The Commission will continue to monitor the budgetary implementation in all Member States currently in the EDP, including the five countries concerned by the current Communication. The next comprehensive assessment will be made in the context of the Commission services' 2012 Spring Forecast.

2. COUNTRY-SPECIFIC ASSESSMENTS

2.1. Belgium

In its recommendations issued in accordance with Article 126(7) of the Treaty on 2 December 2009, the Council recommended Belgium to bring the deficit below 3% of GDP in a credible and sustainable manner by 2012 and to ensure an average annual fiscal effort of ¾% of GDP in 2010-2012. According to the Commission services' 2011 Autumn Forecast, the general government deficit was expected at 3.6% of GDP in 2011 and, assuming that no further measures were taken, at 4.6% of GDP in 2012 and 4.5% of GDP in 2013. The estimated average annual change in the structural balance in 2010-2012 of -0.1% was well below the fiscal effort recommended by the Council. Hence, the projected path of the general government budget deficit combined with the estimated fiscal effort was not consistent with a timely and sustainable correction of the excessive deficit.

After the cut-off date of the 2011 Autumn Forecast, the Belgian government reached an agreement on its 2012 budget proposal, which was formally submitted to Parliament on 21 December 2011. Based on the Commission's assessment of the measures publically announced by the Belgian authorities by 9 January 2012, the general government deficit is projected at 2.9% of GDP in 2012 and 2¾% of GDP in 2013 (see Table 1). As a result, after taking into account all measures up to 9 January 2012, it appears that Belgian authorities have taken effective action towards a timely and sustainable correction of the excessive deficit. A more detailed assessment can be found in the Commission Staff Working Document on Belgium published together with this Communication.

In view of the above assessment, the Commission considers that no further steps in the excessive deficit procedure of Belgium are needed at present. The Commission will continue to closely monitor budgetary developments in Belgium in accordance with the Treaty and the SGP.

Table 1: Belgium - comparison of budgetary projections, general government balance (% of GDP)

	2011	2012	2013
COM AF 2011	-3.6	-4.6	-4.5
National authorities	-3.6	-2.8	-1.8*
COM Jan 2012	-4.1**	-2.9	-2¾

Notes: COM AF 2011 – Commission services 2011 Autumn Forecast. COM Jan 2012 – Commission services' assessment of January 2012. Projections by the national authorities (of 21 December 2011) and the Commission services' assessment of January 2012 take into account the measures announced by the government in the 2012 draft budget.

** According to the April 2011 update of the Stability Programme, the objective for 2013 was -1.8% of GDP; so far, there is no objective for 2013 in the 2012 draft budget.*

*** Revised after taking into account new information on lower-than-expected revenues and additional costs related to the Dexia rescue.*

Sources: Commission services, national projections

2.2. Cyprus

In its recommendations issued in accordance with Article 126(7) of the Treaty on 13 July 2010, the Council recommended Cyprus to bring the government deficit below 3% of GDP in a credible and sustainable manner by 2012 and to ensure an average annual fiscal effort in 2011-2012 of at least 1½% of GDP. According to the Commission services' 2011 Autumn Forecast, the general government deficit was expected at 6.7% of GDP in 2011 and at 4.9% of GDP in 2012, and, assuming that no further measures were taken, at 4.7% of GDP in 2013. Moreover, the estimated average annual change in the structural balance in 2011-2012 of 0.7% of GDP was well below the fiscal effort recommended by the Council. Hence, the projected path of the general government budget deficit in combination with the estimated fiscal effort was not consistent with a timely and sustainable correction of the excessive deficit.

After the cut-off date of the 2011 Autumn Forecast, the Cypriot Parliament on 16 December 2011 adopted the 2012 Budget Law and an additional consolidation package. Based on its assessment of the 2012 budget and the accompanying measures, the Commission foresees the general government deficit to decline to 2.7% of GDP in 2012 and 1.8% of GDP in 2013 (see Table 2). A more detailed assessment can be found in the Commission Staff Working Paper on Cyprus published together with this communication.

On the basis of currently available information, it appears that Cypriot authorities have taken effective action towards a timely and sustainable correction of the excessive deficit. In particular, the Cypriot authorities defined an expenditure-driven consolidation strategy and adopted a 2012 budget based on cautious macroeconomic assumptions and took supporting measures to reduce the deficit. In view of the above assessment, the Commission considers that no further steps in the excessive deficit procedure of Cyprus are needed at present. The Commission will continue to closely monitor budgetary developments in Cyprus in accordance with the Treaty and the SGP.

Table 2: Cyprus - comparison of budgetary projections, general government balance (% of GDP)

	2011	2012	2013
COM AF 2011	-6.7	-4.9	-4.7
National authorities		> -2.5	> -1.0
COM Jan 2012		-2.7	-1.8

Notes: COM AF 2011 – Commission services 2011 Autumn Forecast. COM Jan 2012 – Commission services' assessment of January 2012. Projections by the national authorities (of December 2011) and the Commission services' assessment of January 2012 take into account the measures adopted by the government in the 2012 Budget draft and in an additional consolidation package adopted by the government in December 2011.

Sources: Commission services, national projections

2.3. Hungary

In its recommendations issued on 7 July 2009 in accordance with Article 104(7) of the Treaty establishing the European Communities (TEC)[3], the Council recommended Hungary to bring the deficit below 3% of GDP in a credible and sustainable manner by 2011 and to ensure a cumulative fiscal effort of at least 0.5% of GDP in 2010-2011. According to the Commission services' 2011 Autumn Forecast, Hungary was expected to reach a surplus of 3.6% of GDP in 2011 thanks to temporary measures, and, assuming that no additional consolidation steps were taken, to record a deficit of 2.8% of GDP in 2012, again including measures of a temporary nature, and of 3.7% of GDP in 2013. Since temporary measures do not improve the underlying budgetary position, a substantial deterioration of the structural budget balance of 2¾% of GDP in cumulative terms was estimated in 2010-2011, as opposed to the improvement recommended by the Council. As a result, the projected path of the general government budget deficit in combination with the estimated fiscal effort was not consistent with a sustainable correction of the excessive deficit.

After the cut-off date of the 2011 Autumn Forecast, the approved 2012 budget included additional expenditure and revenue measures compared to the draft proposal. Moreover, the Hungarian authorities further specified their structural reform programme and adopted additional consolidation measures on 15 December 2011. On the same day an agreement was concluded between the government and the banking sector on how to share the burden stemming from the support schemes for distressed mortgage borrowers.

Based on the Commission's assessment of these measures on top of the 2011 Autumn Forecast, the general government deficit is projected at 2¾% of GDP in 2012 and 3¼% of GDP in 2013 (see Table 3), even without taking into account the possible negative effects of a worsening in the macroeconomic scenario and the elevated level of yields. As a result, after taking into account all measures publically announced by the Hungarian authorities by the end of 2011, adequate progress towards a timely and sustainable correction of the excessive deficit is not yet ensured.

Against this background, the Commission adopted a recommendation for a Council decision establishing inadequate action taken under Article 126(8) of the Treaty. A more detailed assessment can be found in the Commission Staff Working Document on Hungary published together with this Communication.

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[3] The corresponding Article in the Treaty on the Functioning of the European Union, which entered into force on 1 December 2009, is Article 126.

Table 3: Hungary - comparison of budgetary projections, general government balance (% of GDP)

	2011	2012	2013
COM AF 2011	3.6	-2.8	-3.7
National authorities	3.9	-2.5	-2.2
COM Jan 2012	3.5	-2¾	-3¼

Notes: COM AF 2011 – Commission services 2011 Autumn Forecast. COM Jan 2012 – Commission services' assessment of January 2012. Projections by the national authorities (of 30 September 2011 and confirmed to the Commission on 15 December 2011) and the Commission services' assessment of January 2012 take into account the measures contained in the 2012 Budget draft and a further consolidation package of 15 December 2011.

Sources: Commission services, national projections

2.4. Malta

In its recommendations issued in accordance with Article 126(7) of the Treaty on 16 February 2010, the Council recommended Malta to bring the deficit below 3% of GDP in a credible and sustainable manner by 2011 and to ensure a fiscal effort of ¾% of GDP in 2011. According to the Commission services' 2011 Autumn Forecast, which was released on 10 November 2011, the general government deficit was estimated at 3% of GDP in 2011 and, assuming that no further measures were taken, the deficit was projected to widen to 3.5% of GDP in 2012 and further to 3.6% of GDP in 2013. While the estimated change in the structural balance in 2011 was in line with the fiscal effort recommended by the Council, the projected path of the general government budget deficit was not consistent with a sustainable correction of the excessive deficit.

After the cut-off date of the 2011 Autumn Forecast, the Maltese government adopted its 2012 budget draft on 14 November 2011. Based on the Commission's assessment of the budget, the general government deficit projections are updated to 2.6% of GDP in 2012 and 2.9% of GDP in 2013 (see Table 4). A more detailed assessment can be found in the Commission Staff Working Document on Malta published together with this Communication.

On the basis of currently available information, it appears that the Maltese authorities have taken effective action towards a timely and sustainable correction of the excessive deficit. In particular, the Maltese authorities adopted a 2012 budget including a series of measures to contain the deficit. In view of the above assessment, the Commission considers that no further steps in the excessive deficit procedure of Malta are needed at present. The Commission will continue to closely monitor budgetary developments in Malta in accordance with the Treaty and the SGP.

Table 4: Malta - comparison of budgetary projections, general government balance (% of GDP)

	2011	2012	2013
COM AF 2011	-3.0	-3.5	-3.6
National authorities	-2.8	-2.3	-1.8
COM Jan 2012	-3.0	-2.6	-2.9

Notes: COM AF 2011 – Commission services 2011 Autumn Forecast. COM Jan 2012 – Commission services' assessment of January 2012. National projections are based on information provided by national authorities complementing the 2012 budget speech. National projections and Commission services' assessment of January 2012 take into account the measures in the 2012 draft budget.

Sources: Commission services, national projections

2.5. Poland

In its recommendations issued in accordance with Article 104(7) of the Treaty establishing the European Communities (TEC)[4] on 6 July 2009, the Council recommended Poland to bring the deficit below 3% of GDP in a credible and sustainable manner by 2012 and to ensure an average annual fiscal effort over the period 2010-2012 of at least 1¼% of GDP. According to the Commission services' 2011 Autumn Forecast, the general government deficit was expected at 5.6% of GDP in 2011 and at 4.0% of GDP in 2012, and, assuming that no further measures were taken, at 3.1% of GDP in 2013. Moreover, taking into account the change in the macroeconomic scenario between the projections underlying the EDP recommendations (i.e. Commission Services' 2009 Spring Forecast) and the 2011 Autumn Forecast, in particular, the fact that Poland had benefited from upward revision of medium-term growth prospects, the estimated average annual change in the structural budget balance in 2010-2012 fell short of the adjustment recommended by the Council. As a result, the projected path of the general government budget deficit and the estimated fiscal effort would, at that stage, not have been consistent with a timely and sustainable correction of the excessive deficit.

After the cut-off date of the 2011 Autumn Forecast, the new Polish government adopted a revised 2012 Budget Law on 8 December 2011. Based on the Commission's assessment of the revised budget on top of the 2011 Autumn Forecast, the general government deficit is projected at 3.3% of GDP in 2012 and 2.6% of GDP in 2013 (see Table 5). A more detailed assessment can be found in the Commission Staff Working Document on Poland published together with this Communication.

In the case of Poland, the assessment in the context of the EDP needs to take into account the provisions of the Six Pack pertaining to the budgetary impact of systemic pension reforms. Notably, in case the excess of the deficit over the reference value of 3% of GDP includes the effects of such a pension reform, the full net direct cost of the reform to the public budget will be taken into account provided (i) the deficit declines substantially and continuously and comes close to the 3% of GDP reference value, (ii) the gross government debt ratio does not exceed 60% of GDP and (iii) overall fiscal sustainability is maintained.

The deficit of 3.3% of GDP expected by the Commission services taking into account measures announced/adopted after the 2011 Autumn Forecast can be considered to be close to the reference value" and the debt-to-GDP ratio is below the 60% of GDP reference value in a sustained manner. This, according to the Council Regulation (EU) No. 1177/2011[5], allows taking into account the cost of a systemic pension reform. The debt ratio would be fairly stable and reach 56% of GDP by 2020 under the assumption of no further policy changes on top of the Commission services' 2011 Autumn Forecast. The Polish authorities estimate the direct net cost of such pension reform at around 0.6% of GDP in 2012.

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4 The corresponding article in the Treaty on the Functioning of the European Union, which entered into force on 1 December 2009, is Article 126.

5 See Article 1(2c). The regulation has amended the modalities according to which budgetary costs related to the introduction of a mandatory, fully-funded pillar in the national pension system can be taken into account when assessing adequate progress towards a timely and sustainable correction of an excessive deficit. In the case of Member States in the EDP where the excess of the deficit over the reference value of 3% includes the effects of such a pension reform, the full net direct cost of the reform to the public budget will be taken into account provided (i) the deficit declines substantially and continuously and comes close to the 3% of GDP reference value, (ii) the gross government debt ratio does not exceed 60% of GDP and (iii) overall fiscal sustainability is maintained.

On the basis of currently available information, it appears that the Polish authorities have taken effective action towards a timely and sustainable correction of the excessive deficit. In view of the above assessment (including also the direct net costs of the systemic pension reform introduced in 1999), the Commission considers that no further steps in the excessive deficit procedure of Poland are needed at present. The Commission will continue to closely monitor budgetary developments in Poland in accordance with the Treaty and the SGP.

Table 5: Poland - comparison of budgetary projections, general government balance (% of GDP)

	2011	2012	2013
COM AF 2011	-5.6	-4.0	-3.1
CP 2011	-5.6	-2.9	-2.5
Draft 2012 Budget Law	n.a.	-2.9*	n.a.
COM Jan 2012	-5.6	-3.3	-2.6

Notes: COM AF 2011 – Commission services 2011 Autumn Forecast. CP 2011 – April 2011 update of the Convergence Programme. COM Jan 2012 – Commission services' assessment of January 2012. The Commission services' assessment of January 2012 takes into account the measures adopted by the government in the draft 2012 Budget Law.

** The budget balance presented in the draft 2012 Budget Law is calculated according to the national method based on cash accounting, which is not directly comparable with the ESA95 accrual accounting method.*

Sources: Commission services, national projections