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BULGARIA - COMMISSION ASSESSMENT IN RELATION TO THE COMMISSION PROPOSAL FOR A COUNCIL DECISION ON THE EXISTENCE OF AN EXCESSIVE DEFICIT (ART. 126(6) OF THE TREATY) AND THE COMMISSION RECOMMENDATION FOR A COUNCIL RECOMMENDATION TO END THE EXCESSIVE DEFICIT SITUATION (ART. 126(7) OF THE TREATY).

1. THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn in 2008/09. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be timely, targeted and temporary and differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted on the debt position or constitute a risk of higher deficits and debt in the future, although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation, and thereby ensuring long-term sustainability of public finances.

2. PREVIOUS STEPS IN THE EXCESSIVE DEFICIT PROCEDURE

Article 126 of the Treaty on the Functioning of the European Union lays down an excessive deficit procedure (EDP). This procedure is further specified in 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.

According to Article 126(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 126(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

On the basis of the data notified by the Bulgarian authorities in April 2010[2] and subsequently validated by Eurostat[3] and taking into account the Commission services' spring 2010 forecast, the Commission adopted a report under Article 126(3) for Bulgaria on 12 May 2010[4].

Subsequently, and in accordance with Article 126(4), the Economic and Financial Committee formulated an opinion on the Commission report on 27 May 2010.

3. THE EXISTENCE OF AN EXCESSIVE DEFICIT

According to the data notified by the Bulgarian authorities in April 2010, the general government deficit in Bulgaria reached 3.9% of GDP in 2009, thus exceeding the 3% of GDP reference value. The Commission report under Article 126(3) considered that the deficit was not close to the 3% of GDP reference value but that the excess over the reference value can be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, it results from a severe economic downturn in the sense of the Treaty and the Stability and Growth Pact, as the global economic and financial crisis hit hard the economy of Bulgaria and the negative annual GDP volume growth reached 5% in 2009. Furthermore, the excess over the reference value could be considered temporary. According to the Commission services' spring 2010 forecast, based on a no-policy change assumption, the general government deficit will fall below the reference value already in 2010 with the stabilization of the economy and as a result of the fiscal consolidation measures announced by the

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1 OJ L 209, 2.8.1997, p. 6. The report also takes into account the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 10 November 2009, available at http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm.

2 According to Council Regulation (EC) No 479/2009, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Bulgaria can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/excessive_deficit/edp_notification_tables.

3 Eurostat news release No 55/2010 of 22 April 2010.

4 All EDP-related documents for Bulgaria can be found at the following website: http://ec.europa.eu/economy_finance/sgp/deficit/countries/index_en.htm.

government at the end of March 2010. In a notification submitted on 22 June 2010, the Bulgarian authorities further revised the planned deficit for 2010 to 3.8% of GDP, above and not close to the reference value. The deficit criterion in the Treaty is not fulfilled.

The data in the April 2010 EDP notification shows that the general government gross debt remains well below the 60% of GDP reference value and stood at 14.8% of GDP in 2009. The Commission services' spring 2010 forecast projects the debt ratio to increase over the 2010-2011 period, but to remain below 19% of GDP. In a notification submitted on 22 June 2010, the Bulgarian authorities further revised the planned debt for 2010 to 15.3% of GDP. The debt criterion in the Treaty is fulfilled.

In line with the provisions in the Treaty and the Stability and Growth Pact, the Commission also analysed in its report "relevant factors". According to the Stability and Growth Pact, these can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the deficit satisfies the double condition of closeness and temporariness. In the case of Bulgaria, the double condition is not met. Considered on their own merit, the relevant factors in the current case on balance seem to be favourable.

The opinion of the Economic and Financial Committee in accordance with Article 126(4) of the Treaty is consistent with the assessment in the Commission report under Article 126(3) on the existence of excessive deficit.

The Commission, having taken into account its report under Article 126(3) and the opinion of the Economic and Financial Committee under Article 126(4), is of the opinion that an excessive deficit exists in Bulgaria. This opinion, adopted by the Commission on 12 May 2010, is herewith addressed to the Council according to Article 126(5). The Commission proposes that the Council shall decide accordingly, in conformity with Article 126(6). In addition, the Commission is submitting to the Council a recommendation for a Council Recommendation to be addressed to Bulgaria with a view to bringing the situation of an excessive deficit to an end according to Article 126(7).

4. RECOMMENDATIONS TO END THE EXCESSIVE DEFICIT SITUATION

According to Article 3(4) of Council Regulation (EC) No 1467/97, the Council recommendation under Article 126(7) has to establish a deadline of six months at most for effective action to be taken by the Member State concerned as well as a deadline for the correction of the excessive deficit, which "should be completed in the year following its identification unless there are special circumstances". Article 2(6) of the Regulation implies that the "relevant factors" considered in the Commission report under Article 126(3) of the Treaty have to be taken into account in deciding whether special circumstances exist. Article 3(4) of the Regulation specifies that the Council has to recommend that the Member State achieves a "minimum annual improvement of at least 0.5% of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation".

In the case of Bulgaria, the relevant factors, as clarified in Article 2(3) of Regulation (EC) No 1467/97 and examined in the Commission's report under Article 124(3), were considered favourable. However, they do not suggest the existence of special circumstances warranting a departure from the standard deadline for correcting the deficit. In particular, in the Commission services' spring 2010 forecast, following the severe contraction in 2009 as a result of the global economic and financial crisis, real GDP growth is projected to gradually recover and reach 2.7% by 2011. In the April 2010 EDP notification the Bulgarian authorities expect the general government budget deficit to fall below the reference value to 2% of GDP in 2010 underpinned by a recovery in real GDP growth to 1% and the additional consolidation package to the tune of 2¼% of GDP from 31 of March 2010. The Commission services' spring 2010 forecast projects the general government budget deficit to improve to 2.8% of GDP in 2010 and to 2.2% of GDP in 2011, based on a no-policy change assumption, on an expected gradual improvement in the growth outlook, and on a prudent assessment of the budgetary impact of the announced consolidation measures. In June the Bulgarian authorities undertook a mid-year revision of the 2010 budget and increased their planned government deficit to 3.8% of GDP. The revision was initiated as a result of a significant downward adjustment of projected government revenues, in the wake of very weak tax data in the first few months of 2010. It aims at ensuring the proper functioning of automatic stabilizers and a more accurate reflection of the domestic and international economic challenges. On the basis of the Commission services' forecast and the latest budgetary and economic developments, the Bulgarian authorities should avoid a deterioration of the 2010 deficit beyond 3.8% of GDP and correct the excessive deficit by 2011 at the latest, implying a structural consolidation effort of around ¾ percentage points of GDP in that year.

The deficit surprise in 2009, in addition to the negative budgetary impact from the downturn, appears also to be related to procedural weaknesses with expenditure planning and implementation control on an accrual basis. The large payment commitments uncovered under annexes to contracts signed by the predecessor government ahead of the July 2009 elections were not planned in the budget and led to additional deterioration of the budgetary position. The negative outcome reflects also the fact that the recent economic good times were not fully used as an opportunity to undertake substantial reforms to improve the efficiency of public spending. In the pre-crisis period Bulgaria has benefited from significant revenue windfalls resulting from buoyant activity and a very tax-intensive growth structure. However, part of these revenue windfalls, instead of being fully saved, have been used to finance relatively high ad-hoc pension increases and public sector wage increases, far above productivity gains, as well as for tax and social security rate cuts.

The non-binding nature of the medium-term fiscal framework in the three-year budgetary planning horizon and the lack of effective spending control mechanisms and expenditure rules have prevented the fiscal position from becoming even stronger, thus further cushioning the negative impact from the downturn on public finances. In addition, the existing budgetary framework allows for certain discretionary spending powers of the government which undermines fiscal transparency and accountability. The lack of reforms in the healthcare sector has repeatedly led to accumulation of hospital arrears and subsequent expenditure overruns. Successive reduction of pension contribution rates combined with pension increases and the absence of offsetting reform measures have brought about a substantial rise in pension spending, posing risks to the sustainability of the system. Furthering reforms in the education system and public administration would contribute to improving administrative capacity and the level of skills and to increasing the efficiency of public spending thus achieving the needed budgetary consolidation.

Enhanced surveillance under the EDP, which seems necessary in view of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy to ensure the correction of the excessive deficit. In this context, until the abrogation of the excessive deficit procedure a separate chapter in the update of the Bulgarian convergence programme, could usefully be devoted to this issue.

Key macroeconomic and budgetary projections

	2007	2008	2009	2010	2011	2012	2013
Real GDP (% change)	6.2	6.0	-5.0	0.0	2.7	n.a.	n.a.
Output gap[1,2] (% of potential GDP)	4.3	5.0	-2.9	-4.8	-4.0	n.a.	n.a.
General government balance (% of GDP)	0.1	1.8	-3.9	-2.8	-2.2	n.a.	n.a.
Primary balance (% of GDP)	1.1	2.7	-3.1	-2.0	-1.4	n.a.	n.a.
Cyclically-adjusted balance[1] (% of GDP)	-1.5	0.0	-2.8	-1.1	-0.8	n.a.	n.a.
Structural balance[3] (% of GDP)	1.8	0.0	-2.8	-1.1	-0.8	n.a.	n.a.
Government gross debt (% of GDP)	18.2	14.1	14.8	17.4	18.8	n.a.	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 3.4%, 3.1% and 2.9% 2009-2011.

[3] Cyclically-adjusted balance excluding one-off and other temporary measures. There are no one-off and other temporary measures in the most recent programme and Commission services' autumn forecast.

Source:

Commission services' spring 2010 forecasts (COM); Commission services' calculations.