

Part I

Current developments and prospects

SUMMARY

Bold policy measures taken at both the EU and Member States level have led to an easing of financial tensions in 2012 and broken the vicious cycle between sovereign and banking risks, but without being reflected in economic growth. Economic activity was disappointing in 2012, stagnating in the EU and shrinking in the euro area. Growth is expected to continue to falter in 2013 with the Commission's services 2013 spring forecast, showing growth of -0.1% in the EU and of -0.4% in the euro area. The recovery is expected to slowly take off by the end of 2013, mainly driven by external demand with moderate growth returning in 2014.

Growth developments in the EU revealed wide disparities and different dynamics across Member States reflecting different external and internal rebalancing needs, as well as differing developments in competitiveness. Indeed in 2012, while some Member States continued to grow, others re-entered recession: real GDP growth ranged from over 3% in the Baltics to large negative values in a number of countries (Greece, Portugal, Cyprus, Italy and Slovenia).

Against this background, Chapter I.1 presents the economic and budgetary outturns for 2012, discussing Member States' public finances, the context in which they are set, and perspectives for the coming years and Chapter I.2 presents the related developments in surveillance.

In 2012, as detailed in section I.1.2, a strong fiscal retrenchment was implemented in the EU, with a reduction in the aggregate structural balance by more than 1pp for the second year in a row while still under difficult economic conditions. Compared with 2011, the structural balance tightened by 1.1pp of GDP in the EU and 1.5pp of GDP in the euro area.

Weak economic growth has meant that this strong adjustment in structural balances has not been entirely reflected in magnitude on the headline values. In 2012, the EU average headline deficit came in at 4.0% of GDP, down from 4.4% in 2011 and at 3.7% in euro area, down from 4.2% in 2011. The reduction in government deficits in recent years has been impressive, as they continue to fall from an average high of over 6% of GDP in both 2009 and 2010. Commission's forecasts show that consolidation efforts will be maintained in 2013,

though at a slower pace than in 2012, with the tightening easing further in 2014. However it has to be reminded that Commission's forecasts for 2014 are made under the assumption that policies are unchanged which prevents the Commission from taking into account future measures. Despite this progress achieved in terms of the consolidation efforts, budget deficits are still expected to remain sizeable in a number of countries over the next few years. Overall, the average headline deficit is forecast to decline to 3.4% of GDP in the EU and 2.9% in the euro area in 2013, with a more limited decrease in 2014.

The effect of these years of large deficits has been a significant increase in government debt, which is forecast to continue this year before stabilising in 2014, as presented in Section I.1.3. The impact of the primary deficit has also been compounded by the snow-ball effect. Debt increased from 59.0% of GDP in the EU and 66.4% in the euro area in 2007 to reach 86.9% of GDP and 92.7% of GDP respectively, in 2012. By 2014, it is forecast to attain 90.6% in the EU and 96.0% in the euro area under the no-policy change assumption.

The sustained consolidation efforts achieved by Member States are being reflected in the implementation of the Stability and Growth Pact (SGP), in particular in its corrective arm the Excessive Deficit Procedure (EDP). This is presented in Chapter I.2, which describes the implementation of the SGP, focussing on the sixteen EDPs that were on-going in 2012 due to deficits having exceeded the Treaty limit of 3% of GDP.

On the basis of the 2013 Commission Spring forecast, the Commission recommended to the Council the abrogation of the EDPs for Italy, Latvia, Lithuania, Romania and Hungary, based on a lasting correction of their deficits. Concerning countries that are not in line with the deadline to correct their nominal deficit, or that are not on course to meet it, the Commission recommended a stepping up of the procedure, setting a deadline of 2013 for Belgium – which did not bring its deficit below 3% of GDP by the 2012 deadline, while it had also not delivered the required structural adjustments either. On the other hand, since it has been considered that effective action had been taken, a deadline extension was recommended for Cyprus, France, the Netherlands, Poland, Slovenia,

Spain and Portugal. Finally, the Commission proposed that a new procedure be opened for Malta. These developments are discussed in Section I.2.1.

The remainder of the Chapter discusses developments concerning the preventive arm of the SGP, i.e. concerning Member States which are not in EDP, based on the 2013 updates of the Stability and Convergence Programmes (SCPs) submitted by Member States this Spring. It also features a stock-taking of the implementation of the Directive on national budgetary requirements (“the Directive”) approved in 2011 as part of the Six Pack.

First, Section I.2.2 considers Member States' plans based on the SCPs they submitted in the context of the European Semester. Overall, the macroeconomic assumptions underpinning the SCP plans are similar to those of the Commission Spring forecast. The SCPs show that consolidation is planned to continue, with its pace slowing over time as the result of frontloaded consolidation, following the significant reductions in deficits achieved over 2010-12 in many Member States. When compared to the Commission forecasts, the SCP deficit plans are similar in 2013, but envisage smaller deficits in 2014. The more ambitious targets for 2014 should mainly be read as the result of a policy gap: this means that, in order for Member States to reach their SCP targets, they would need to introduce new policy measures. This represents an element of risk, as the achievement of the plans relies on the political willingness to drive these policies through.

As well as a reduction in deficits, this section shows that government policies have also resulted in a reduction of the sustainability risk. Relative to 2009, there has been a large reduction in the number of countries above the threshold for short-term fiscal stress, as estimated by the Commission's S0 indicator. If Member States' plans are implemented as described in the SCPs, the gains in debt sustainability are projected to persist over the medium term, before costs of ageing gradually increase.

Finally, Section I.2.3 discusses the status of the transposition of the Directive by Member States on the basis of the interim report prepared by the Commission in December 2012. This Section

shows substantial but uneven progress across Member States in the transposition process, with areas where improvements are clearer – regarding numerical fiscal rules for instance, while existing provisions still lack details or are partial concerning other elements of the Directive – for example, regarding some parts of the accounting and statistical provisions and the forecast provisions. The Section features a selected number of recent reforms, with the aim of illustrating each Chapter of the Directive with one example of reform as part of its transposition

1. CURRENT DEVELOPMENT AND PROSPECTS

1.1. ECONOMIC DEVELOPMENTS AND PERSPECTIVE ON CONSOLIDATION

Since mid-2012, financial market stress in the EU has eased, on the back of important policy measures adopted both at the EU and at the Member State level (e.g. establishment of the European Stability Mechanism, introduction of the ECB's Outright Monetary Transactions, decision by the European Council to strengthen the architecture of the EMU, including by creating a Banking Union, as well as significant fiscal adjustment and structural reforms conducted by Member States). Altogether, these policy measures have contributed to reducing tail risks and to weakening the vicious circle between fragile public finances, vulnerable banks and weak economic activity, which had fuelled the sovereign-debt crisis before mid-2012.

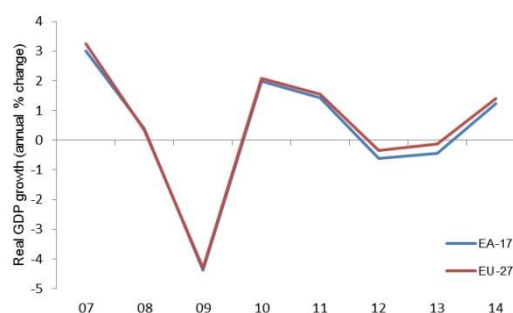
Nonetheless, the improvements in the financial conditions have had limited impact on the real economy so far. Economic activity disappointed in the second half of 2012, and turned out weaker than expected in the first quarter of 2013. This was due to two interrelated set of factors. First, because of persistent weaknesses in the banking sector, the improvement in the financial markets' situation has not yet fed in the credit growth. Credit conditions remain tight, especially across the euro area periphery, and interest rates on new loans to households and corporates have not declined significantly. Second, the process of deleveraging of the private and the public sector is still on-going in many economies, and this weighs on aggregate demand. In particular, domestic demand remains muted due to high unemployment and as a result of persistent uncertainty amongst households and enterprises regarding the future economic outlook and the development of the debt crisis. At the same time, given the remaining fiscal sustainability concerns, governments in many Member States have to continue the necessary fiscal retrenchment.

Looking ahead, latest developments in leading indicators point to delays in the return of confidence in the private sector, and suggest that stabilisation of the EU economy is still fragile in the first half of 2013. Based on the assumption that the above mentioned policies to reinforce the EMU will be effectively implemented and thus reduce

uncertainty, the Commission Spring forecast project recovery to slowly take off by the end of 2013. This recovery will mainly be driven by external demand, with economic activity projected to return to moderate growth only in 2014. Still, the on-going deleveraging in the private sector, together with the need to continue fiscal consolidation in several Member States, even if at a reduced pace, are expected to weigh on the speed of the recovery, especially in the euro area. These drags on growth should, however, gradually fade away: an improved situation in government finances and a rebound in confidence and in GDP growth would then help the European economy to enter in a virtuous self-reinforcing circle by 2014.

Graph I.1.1 presents forecasts for real GDP growth according to the Commission 2013 Spring forecast. In 2013, annual GDP is projected broadly unchanged from 2012 (-0.1%) in the EU27, while it is expected to shrink (-0.4%) in the euro area. These developments follow a drop in GDP growth in 2012 for both the EU27 (-0.3%) and the euro area (-0.6%). However, the outlook for 2014 is encouraging, with EU and euro area GDP growth expected to rebound to 1.4% and 1.2%, respectively (even though, given the no-policy change assumption, these figures do not reflect the measures that will be taken for 2014).

Graph I.1.1: Real GDP growth



Source: Commission service

The overall growth developments in the EU mask divergent dynamics across Member States. These wide disparities stem, among other things, from differences in factors affecting domestic demand (e.g. developments in real disposable income, changes in confidence) which in turn reflect fundamental differences in external and internal

rebalancing needs across the EU. While some Member States continued to grow in 2012, others re-entered recession. GDP growth ranged from 5.6% in Latvia and over 3% in Estonia and Lithuania to -6.4% in Greece, followed by -3.2% in Portugal, -2.4% in Cyprus and Italy, and -2.3% in Slovenia. Negative growth rates were recorded also in Belgium, Spain, the Netherlands, Finland, Czech Republic, Denmark and Hungary. In 2013, among the largest Member States, GDP is expected by the Commission 2013 Spring forecast to increase in Poland (1.1%), the United Kingdom (0.6%) and Germany (0.4%), while it is forecast to decrease in Spain (-1.5%), Italy (-1.3%), the Netherlands (-0.8%) and France (-0.1%).

The state of the labour market is a serious concern for the EU. Adverse labour market developments not only have severe social consequences, but also weigh on growth perspectives and on the sustainability of public finances. These effects could be increased by high hysteresis effects. In contrast to the experience of 2009, when the labour market proved very resilient to the shock of the economic crisis, mainly thanks to adjustment in the working hours and supportive policy measures, the current outlook is characterised by a marked deterioration of employment and a risk of permanent job losses. In line with weak economic activity, unemployment increased to 10.5% in 2012 (11.4% in the euro area) and is expected to further increase in 2013 to 11.1% (12.2% in the euro area), and to stabilize in 2014. At the same time, the non-accelerating wage rate of unemployment (NAWRU), which can be considered a gauge of structural unemployment, has been increasing substantially since 2008.

However, labour market developments differ substantially across countries. Member States which undergo necessary large-scale fiscal adjustments experience rapid and deep deterioration in their labour market. Hence, the highest unemployment rates are observed in Greece and Spain, followed by Portugal, while the unemployment rate in Cyprus is expected to almost double in 2013, compared to 2011. Among large Member States, unemployment rate will continue to increase in Spain, Italy, the Netherlands, and France, while it is set to remain broadly stable in the United Kingdom and in Germany (which displays among the lowest unemployment rates in the EU).

Consolidation of public finances has been strong over 2010-2012, yielding a sizable improvement of the budgetary positions in the EU and the euro area. After the fiscal stimulus in 2009-2010, in face of increasing debt and intensifying market tensions, Member States stepped up consolidation to avert risks to their debt sustainability. The size of the on-going consolidation in public finances is remarkable, as it occurs at the time of output contraction and mostly negative and widening output gaps. In particular, in 2012, an already negative output gap widened by almost 1pp of GDP in both the EU and the euro area. In 2013, it is expected to widen further. Given the progress made in fiscal consolidation and the reinforcement of the economic governance, fiscal tightening is expected to decelerate in 2013, according to the 2013 update of the Stability and Convergence Programmes (see I.2.2), fiscal tightening is expected to decelerate as from 2013.

Although fiscal consolidation has led to visible reduction in deficits, which can be expected to continue, albeit at a slower pace, those deficits will remain sizeable in the next few years in certain countries, while the debt-to-GDP ratio is projected to start stabilising only by 2014.

1.2. SHORT-TERM DEVELOPMENTS IN BUDGET DEFICITS

Table I.1.1 shows the budget balance for the 27 EU Member States from 2010 to 2014 on the basis of the Commission 2013 Spring forecast. Consolidation efforts are bearing fruits. In 2012 the EU headline deficit came in at 4.0% of GDP, down from 4.4% in 2011 and 6.5% in 2010 (in the euro area 3.7% in 2012, 4.2% in 2011 and 6.2% in 2010). Against the current growth outlook, the aggregate EU deficit is forecast to decline to 3.4% of GDP in 2013 and to continue decreasing to 3.2% of GDP in 2014. Broadly the same profile is expected for the euro area: the aggregate deficit is forecast to decline to 2.9% of GDP in 2013 and to continue decreasing to 2.8% of GDP in 2014.

In both the EU and the euro area, the decrease in the headline deficit has been accompanied by a larger decrease (by 1.1 and 1.5 pp, respectively) in the structural deficit, i.e. the headline deficit net of cyclical factors and one-off and other temporary measures.

Table I.1.1: Budget balance in EU Member States (% of GDP)

	Budget balance					Structural balance					Structural primary balance				
	2010	2011	2012	2013*	2014*	2010	2011	2012	2013*	2014*	2010	2011	2012	2013*	2014*
BE	-3.8	-3.7	-3.9	-2.9	-3.1	-3.4	-3.5	-3.0	-2.3	-2.3	0.0	-0.2	0.4	0.9	0.9
DE	-4.1	-0.8	0.2	-0.2	0.0	-2.3	-0.9	0.3	0.4	0.3	0.2	1.6	2.8	2.8	2.6
EE	0.2	1.2	-0.3	-0.3	0.2	-1.1	-0.6	0.2	-0.2	0.2	-1.0	-0.5	0.3	0.0	0.3
IE	-30.8	-13.4	-7.6	-7.5	-4.3	-9.1	-7.7	-7.4	-6.9	-4.8	-5.9	-4.3	-3.7	-1.9	0.2
EL	-10.7	-9.5	-10.0	-3.8	-2.6	-8.8	-5.4	-1.0	2.0	2.0	-3.0	1.8	4.0	5.9	6.4
ES	-9.7	-9.4	-10.6	-6.5	-7.0	-7.4	-7.2	-5.5	-4.4	-5.5	-5.5	-4.8	-2.5	-1.0	-2.0
FR	-7.1	-5.3	-4.8	-3.9	-4.2	-5.8	-4.7	-3.6	-2.2	-2.3	-3.4	-2.0	-1.0	0.3	0.2
IT	-4.5	-3.8	-3.0	-2.9	-2.5	-3.7	-3.6	-1.4	-0.5	-0.7	0.9	1.4	4.1	4.8	4.9
LU	-0.9	-0.2	-0.8	-0.2	-0.4	-0.1	0.3	0.1	0.7	0.3	0.3	0.8	0.5	1.2	0.8
NL	-5.1	-4.5	-4.1	-3.6	-3.6	-4.0	-3.7	-2.6	-2.0	-2.3	-2.0	-1.6	-0.7	-0.1	-0.4
AT	-4.5	-2.5	-2.5	-2.2	-1.8	-3.3	-2.2	-1.5	-1.6	-1.7	-0.7	0.4	1.1	1.0	0.9
PT	-9.8	-4.4	-6.4	-5.5	-4.0	-8.8	-6.6	-4.2	-3.6	-2.0	-6.0	-2.5	0.2	0.7	2.3
SI	-5.9	-6.4	-4.0	-5.3	-4.9	-4.7	-4.7	-2.7	-2.4	-3.3	-3.0	-2.8	-0.6	0.0	-0.5
FI	-2.5	-0.8	-1.9	-1.8	-1.5	-0.7	-0.1	-0.7	-0.6	-0.5	0.3	1.0	0.3	0.4	0.5
MT	-3.6	-2.8	-3.3	-3.7	-3.6	-4.6	-3.6	-4.1	-3.8	-3.7	-1.6	-0.5	-1.0	-0.6	-0.5
CY	-5.3	-6.3	-6.3	-6.5	-8.4	-5.7	-6.6	-6.7	-5.4	-5.1	-3.5	-4.2	-3.6	-1.3	-1.0
SK	-7.7	-5.1	-4.3	-3.0	-3.1	-7.1	-5.2	-4.1	-3.0	-2.4	-5.8	-3.7	-2.3	-1.1	-0.5
EA-17	-6.2	-4.2	-3.7	-2.9	-2.8	-4.5	-3.6	-2.1	-1.4	-1.5	-1.6	-0.5	1.0	1.7	1.5
BG	-3.1	-2.0	-0.8	-1.3	-1.3	-2.1	-1.6	-0.4	-0.8	-0.9	-1.4	-0.8	0.5	0.1	0.1
CZ	-4.8	-3.3	-4.4	-2.9	-3.0	-4.5	-3.0	-1.7	-1.6	-2.1	-3.1	-1.7	-0.2	0.0	-0.4
DK	-2.5	-1.8	-4.0	-1.7	-2.7	-0.2	0.3	0.3	0.0	-0.3	1.5	2.0	2.0	1.6	1.3
LV	-8.1	-3.6	-1.2	-1.2	-0.9	-2.9	-1.6	-0.3	-1.4	-1.5	-1.5	-0.1	1.0	0.1	0.1
LT	-7.2	-5.5	-3.2	-2.9	-2.4	-4.7	-4.9	-3.2	-2.8	-2.8	-2.9	-3.1	-1.3	-1.0	-1.0
HU	-4.3	4.3	-1.9	-3.0	-3.3	-3.3	-4.1	-0.7	-1.1	-1.8	0.8	0.0	3.4	3.1	2.1
PL	-7.9	-5.0	-3.9	-3.9	-4.1	-8.3	-5.4	-3.8	-3.3	-2.9	-5.6	-2.7	-0.9	-0.6	-0.4
RO	-6.8	-5.6	-2.9	-2.6	-2.4	-6.2	-4.0	-2.7	-1.7	-1.4	-4.7	-2.4	-0.9	0.1	0.4
SE	0.3	0.2	-0.5	-1.1	-0.4	1.3	0.2	0.2	-0.1	0.3	2.1	1.3	1.0	0.6	1.0
UK	-10.2	-7.8	-6.3	-6.8	-6.3	-8.9	-6.8	-7.0	-5.7	-5.4	-5.9	-3.5	-4.0	-2.8	-2.5
EU-27	-6.5	-4.4	-4.0	-3.4	-3.2	-4.9	-3.9	-2.8	-2.0	-2.1	-2.2	-0.9	0.2	0.9	0.8

Note: The structural budget balance is calculated on the basis of the commonly agreed production function method (see European Commission (2004)).

* Figure from the 2013 Commission Spring 2013 forecast. Source: Commission services

Source:

Still, the aggregate figures hide different developments between Member States. Those different budgetary developments reflect mainly uneven starting conditions, different impact of the crisis on the Member States' budgets, as well as different needs for banks recapitalisation. In 2012, the largest adjustment took place in Ireland, whose headline deficit in 2012 came in at 7.6% of GDP, down from 13.4% in 2011. Among euro area countries, a marked improvement was recorded

also in Slovenia (4.0% of GDP, after 6.4% in 2011). Improvements between 1.0 and 3/4 pp of GDP were recorded in Germany, Italy and Slovakia, while France and the Netherlands achieved smaller improvements. Other euro area countries saw a deterioration of their budgetary positions, the greatest being in Estonia(-0.3% of GDP after the 1.2% surplus in 2011), Portugal

Table I.1.2: Euro Area- The general Government budget balance (%of GDP)

	2009	2010	2011	2012	2013*	2014*
Total revenue (1)	44.9	44.8	45.3	46.2	46.8	46.5
Total expenditure (2)	51.2	51.0	49.5	49.9	49.7	49.3
Actual balance (3) = (1) - (2)	-6.4	-6.2	-4.2	-3.7	-2.9	-2.8
Interest (4)	2.9	2.8	3.0	3.1	3.1	3.1
Primary balance (5) = (3) + (4)	-3.5	-3.4	-1.1	-0.6	0.2	0.3
One-offs (6)	0.0	-0.7	0.0	-0.4	0.1	0.0
Cyclically adjusted balance (7)	-4.5	-5.1	-3.5	-2.6	-1.4	-1.6
Cyclically adj. prim. balance = (7) + (4)	-1.7	-2.3	-0.5	0.5	1.7	1.5
Structural budget balance = (7) - (6)	-4.5	-4.5	-3.6	-2.1	-1.4	-1.5
Change in actual balance:	-4.2	0.2	2.1	0.4	0.8	0.1
- Cycle	-2.7	0.8	0.4	-0.5	-0.4	0.4
- Interest	-0.2	0.0	0.2	0.1	0.0	0.0
- Cycl.adj.prim.balance	-1.7	-0.6	1.8	1.0	1.2	-0.2
- One-offs	0.0	-0.7	0.7	-0.5	0.5	-0.1
- Structural budget balance	-1.6	0.0	0.9	1.4	0.8	-0.2

Note: Differences between totals and sum of individual items are due to rounding

* Figure from Commission services' Spring 2013 forecast

Source: Commission services

Box 1.1.1: Budgetary developments in programme countries

Four euro area Member States have received financial assistance from EU funds and the IMF: Greece, Ireland, Portugal and Cyprus. These policy loans are subject to conditionality that aims at improving debt sustainability and restoring macroeconomic balances and financial stability. Under their programmes the four countries have implemented budgetary measures according to the agreed Memoranda of Understanding (MoUs). Spain received EU financial assistance to address problems in its financial sector, but the conditionality of its programme did not contain budgetary measures. As for non-euro area member states, the programme for Romania under the Balance of Payments (BOP) facility ended in March 2013. This box gives a brief overview of the most important budgetary developments in the remaining four programme countries.

Greece

The general government deficit amounted to 10% of GDP in 2012 reflecting one-off costs associated with the resolution of three banks of almost 4% of GDP. Net of these one-off measures, despite continued headwind from the deep recession, Greece is estimated to have achieved a headline deficit of 6.3%, and a primary deficit of 1.3% of GDP, slightly better than expected. On the basis of the last package of measures taken in November 2012 amounting at almost 6.5% of GDP over 2013-14 in the context of the programme, Greece is expected to achieve primary balance in 2013. Recent developments are broadly in line with this programme target although there are risks in certain areas of the budget. The revenue outlook is adversely impacted by weaker-than-expected social security contribution collection and delays in property tax revenues. In the first months of 2013 there have been significant expenditure overruns in the health sector, but measures are being taken to address these slippages. Assuming the effective implementation of the budget according to the programme, the bank recapitalisation in 2013 will have a very significant impact on the headline deficit compared to the current forecast. This could not be included in spring forecasts as the exact nature and size of such impact on the deficit depends on the ultimate form of the operations, which were not yet finalised. In structural terms, the improvement is even more significant leading to a projected structural balance of 2% of GDP in 2014, up from some -14¾% in 2009, reflecting a clear turnaround in the fiscal position compared to the beginning of the crisis.

The ratio of public debt to GDP in 2012 was 156.9% down from 170.3% in 2011. This reduction was mainly driven by the debt buy back completed on 11 December 2012. The above mentioned ratio is expected to rise in 2013. However, from 2014 and onwards, the debt ratio is projected to decline at an accelerating pace as the fiscal balance continues improving and economic growth resumes.

Ireland

The 2012 deficit excluding one-off bank-support measures was 7.6% of GDP, well within the programme ceiling of 8.6%. This reflects continued determined budgetary implementation and strong revenue collection, but also favourable surprises in one-off revenues. The 2013 deficit is estimated at the ceiling of 7.5% of GDP. The adjustment effort of 2.5% of GDP in 2013 results only in a marginal reduction of the headline deficit, due to a series of deficit-increasing one-off elements. Those include transactions costs related to the liquidation of Irish Bank Resolution Corporation, while the overall operation, including the exchange of the promissory notes with the long-dated government bonds, will deliver significant fiscal gains from 2014.

The debt/GDP level reached 117% in 2012 and is expected to peak in 2013 at 122% declining thereafter. The exchange of the promissory notes with government bonds with lower interest rates and longer maturity in early 2013 had no immediate impact on the government debt level, but will lower the future debt path as a result of interest cost savings.

(Continued on the next page)

Box (continued)

Portugal

Amid a challenging macroeconomic environment Portugal undertook a large fiscal consolidation effort in 2012. In spite of rigorous budget implementation on the expenditure side, large revenue shortfalls resulting from a deterioration of the economic activity and the faster-than-expected adjustment from domestic demand towards the exports, led to a revision of the fiscal adjustment path. The general government deficit in 2012 was above target, at 6.4% of GDP. However, without the impact of a number of unexpected one-off operations, the general government deficit would have been 4.7% of GDP. Confining the deficit required additional consolidation measures. All in all, the fiscal effort in 2012 as measured by the change in the structural balance was 2.4% of GDP. Potential output has been revised downward since and tax elasticities have been much lower than average (see Part III.) Without such effects the measured effort would have been much higher.

Gross public debt rose from 108.3% of GDP in 2011 to 123.6% of GDP in 2012, mainly driven by higher interest expenditure and the evolution of real growth. In addition, the statistical treatment of some operations also contributed to the upward shift of the debt ratio. Going forward the debt is expected to engage in a sustainable downward path from 124% of GDP in 2014 if fiscal consolidation effort is maintained and the government implements the measures contained in the MoU such as the completion of the privatisation efforts.

Cyprus

Already in 2012 before the programme started, the government aimed at improving budgetary outcomes by increasing the VAT, better targeting of social transfers and reductions of public sector wages. Under the programme, Cyprus aims to achieve a continuous strengthening of the primary balance, resulting in a primary surplus of 3% of GDP in 2017 and 4% of GDP in 2018, and maintaining at least such a level thereafter. The measures agreed in the MoU for 2013 comprise inter alia increases of the statutory corporate income tax, the interest income withholding tax and the bank levy.

Public debt rose by almost 15 pp. to 85.8% of GDP in 2012, mostly due to bank recapitalisation. For 2013 and 2014, the debt-to-GDP ratio is expected to rise to unprecedented levels of 109.5% and 124%, largely driven by recapitalisation of financial institutions and the continued contraction in GDP.

(6.4% after 4.4% in 2011) and Spain, (10.6% after 9.4% in 2011). Deficits increased also in Finland, Luxembourg, Greece, Malta and Belgium. In 2012 Germany was the only EU Member State to have posted a surplus (0.2% of GDP). According to the Commission 2013 Spring forecast (based on the no-policy-change assumption that only legislated measures are taken into account), most of the euro area Member States will record improvements in their budgetary positions over the forecast horizon, although developments vary across the countries.

Outside the euro area, in Hungary, Czech Republic, Denmark and Sweden, budgetary positions deteriorated in 2012, although from a surplus in case of Hungary and Sweden. The deterioration in the headline deficit of Hungary (about 6½ points of GDP) came in after the country had experienced an unprecedented

improvement (about eight points of GDP) in 2011, due to the one-off accounting impact of a reform of the pension system. Both Czech Republic and Denmark had an increase in the headline deficits in 2012, but their budgetary positions are forecast to improve again in 2013. Latvia and Romania brought down their deficits below 3% of GDP in 2012 and are projected to continue – albeit at a much slower pace – the deficit reductions until 2014. The United Kingdom posted the highest headline deficit (6.3% of GDP) outside the euro area, which is expected to further worsen (up to 6.8%) in 2013.

From the perspective of EU fiscal rules, only 11 Member States had in 2012 headline deficits below or equal to 3% of GDP Treaty reference value. After correcting the excessive deficits, Member States are mandated by the Pact to progress

towards their country-specific Medium Term budgetary Objective (MTO), which is a target for their structural balance which should ensure fiscal sustainability over the medium term (see Chapter II.3). In 2012, Germany and Estonia were the only euro area Member State that had achieved their MTOs. Outside the euro area, Bulgaria, Denmark, Latvia, Hungary and Sweden have also reached their MTOs.

1.3. SHORT-TERM DEVELOPMENTS IN DEBT

Average government debt in the EU was standing at 86.9% of GDP in 2012, up by 3.8 pp relative to 2011. It is projected to continue rising to 89.8% of GDP in 2013 and 90.6% in 2014. In the euro area, debt levels reached 92.7% of GDP in 2012, from 4.7 pp in 2011. They are projected to rise to 95.5% of GDP in 2013 and to 96% in 2014.

Table I.1.3 shows the projected change in the government debt ratio between 2009 and 2014 according to the Commission 2013 Spring forecast, and the composition of the change in terms of primary balance, the "snowball effect", and stock-flow adjustments. For the EU, as whole, deficit appears to have been the main driver of debt accumulation, followed by stock-flow adjustments. In the euro area, however, the snowball effect was the biggest component of the increase in the debt ratio, as a number of Member States with a high (starting) level of debt have faced both an increase in refinancing costs and a more negative GDP development.

Aggregate EU and euro area figures for debt levels again mask considerable variation across Member States in their evolution over the past years. In 2012, debt ratios ranged between 10.1% of GDP in Estonia (whose debt, however, increased by about 4 pp from 2011) to 156.9% in Greece (which posted a decrease of about 13 pp relative to 2011, as a result of its debt restructuring). Over the last 4 years, debt-to-GDP ratios have been on a broadly increasing path in all EU Member States, except for Greece in 2012, Sweden (where debt has been steadily declining since 2009), Hungary and Latvia (debt has been declining in 2011 and 2012), Denmark and Poland (debt decreased in 2012 for the first time since 2009).

In 2012, increases in debt-to-GDP ratios from 2011 were particularly marked in Spain, Cyprus and Portugal (by about 15 pp), Ireland (11 pp), Slovakia (9 pp), Slovenia and Italy (more than 6 pp). But these developments hide different pre-crisis debt levels and diverging dynamics. Ireland, whose debt level was relatively low before the crisis, saw its debt rocketing in 2009-2010 as result of the public interventions in the financial sector.

However, since 2011, the rate of debt increase has remained moderate and Irish debt is projected to start declining in 2014, after reaching a peak at 123.3% of GDP in 2013. On the contrary, debt increase has been accelerating over the last year in Spain, Slovakia and Cyprus.

Overall, the continuously rising debt-to-GDP ratios reflect the combined effect of high primary deficits, negative or very weak growth, and high interest expenditure in some Member States. In particular, the large differential between the real interest rate and the real GDP growth continued to push up debt in Italy, despite the primary surpluses recorded since 2010. Negative GDP growth has aggravated the debt challenge in Spain, as well as in Greece and Portugal. Public interventions to support the financial sector have also contributed to the rise in debt and to its heterogeneity across countries.

Six Member States (Belgium, Ireland, Greece, Italy, Cyprus and Portugal) are expected to record a debt level above 100% of GDP by 2013. In Greece, the already very high debt ratio, after a drop in 2012, is expected to continue increasing in 2013, reaching 175.0% of GDP in 2014 (under a no-policy-change assumption).

Italy's debt-to-GDP ratio hit the 100% threshold before the crisis; it has been continuously rising since then and is forecast to exceed 130% by 2014. In Portugal the debt-to-GDP ratio exceeded 100% in 2011 and is set to continue growing to 124.3% in 2014 (after a small drop in 2013). Belgium's debt is forecast to increase above 100% of GDP in 2013 and to continue rising in 2014.

Germany, France, Hungary, Malta, the Netherlands, Austria and the United Kingdom also had debt ratios above the 60% of GDP threshold in 2012, and further increases are projected over the forecast horizon in all these countries, except

Table I.1.3: Composition of changes in the government debt ratio in EU Member States (% of GDP)

	Gross debt ratio						Change in debt ratio 2009-14*	Change in the debt ratio in 2009-14 due to:		
	2009	2010	2011	2012	2013*	2014*		Primary balance	Interest & growth contribution	Stock-flow adjustment
BE	95.7	95.5	97.8	99.6	101.4	102.1	6.4	1.0	2.6	2.9
DE	74.5	82.4	80.4	81.9	81.1	78.6	4.1	-7.3	-0.3	11.8
EE	7.2	6.7	6.2	10.1	10.2	9.6	2.4	-1.8	-1.9	6.1
IE	64.8	92.1	106.4	117.6	123.3	119.5	54.7	43.4	10.8	0.5
EL	129.7	148.3	170.3	156.9	175.2	175.0	45.4	10.5	62.4	-27.5
ES	53.9	61.5	69.3	84.2	91.3	96.8	42.9	29.1	12.3	1.4
FR	79.2	82.4	85.8	90.2	94.0	96.2	17.0	12.8	2.7	1.5
IT	116.4	119.3	120.8	127.0	131.4	132.2	15.8	-9.3	19.4	5.7
LU	15.3	19.2	18.3	20.8	23.4	25.2	9.8	0.4	-2.9	12.3
NL	60.8	63.1	65.5	71.2	74.6	75.8	15.0	11.1	4.6	-0.7
AT	69.2	72.0	72.5	73.4	73.8	73.7	4.5	0.4	0.7	3.4
PT	83.7	94.0	108.3	123.6	123.0	124.3	40.6	10.2	21.0	9.5
SI	35.0	38.6	46.9	54.1	61.0	66.5	31.4	15.7	10.8	5.0
FI	43.5	48.6	49.0	53.0	56.2	57.7	14.2	3.3	-3.1	14.0
MT	66.4	67.4	70.3	72.1	73.9	74.9	8.6	1.4	1.9	5.2
CY	58.5	61.3	71.1	85.8	109.5	124.0	65.5	16.8	23.4	25.3
SK	35.6	41.0	43.3	52.1	54.6	56.7	21.1	14.6	-0.7	7.2
EA-17	80.0	85.6	88.0	92.7	95.5	96.0	16.0	4.6	6.5	4.9
BG	14.6	16.2	16.3	18.5	17.9	20.3	5.6	4.4	0.9	0.3
CZ	34.2	37.8	40.8	45.8	48.3	50.1	15.9	10.9	5.1	-0.2
DK	40.7	42.7	46.4	45.8	45.0	46.4	5.7	4.6	2.1	-1.0
LV	36.9	44.4	41.9	40.7	43.2	40.1	3.2	7.8	-4.8	0.2
LT	29.3	37.9	38.5	40.7	40.1	39.4	10.1	12.3	-2.9	0.7
HU	79.8	81.8	81.4	79.2	79.7	78.9	-0.9	-12.4	6.3	5.3
PL	50.9	54.8	56.2	55.6	57.5	58.9	8.0	11.4	0.9	-4.3
RO	23.6	30.5	34.7	37.8	38.6	38.5	14.9	11.7	-0.5	3.7
SE	42.6	39.4	38.4	38.2	40.7	39.0	-3.5	-2.6	-4.2	3.3
UK	67.8	79.4	85.5	90.0	95.5	98.7	30.8	22.4	3.0	5.4
EU-27	74.6	80.2	83.1	86.9	89.8	90.6	16.0	7.1	3.9	4.9

Note: Differences between the sum and the total of individual items are due to rounding

* Figure from Commission services' Spring 2013 forecast

Source: Commission services

Table I.1.4: Euro area- Government revenue and expenditure (% of the GDP)

	2009	2010	2011	2012	2013*	2014*
Total revenue	44.9	44.8	45.3	46.2	46.8	46.5
Taxes on imports and production (indirect)	12.5	12.7	12.8	13.0	13.1	13.1
Current taxes on income and wealth	11.6	11.5	11.9	12.4	12.7	12.5
Social contributions	15.8	15.7	15.7	15.9	16.0	15.9
of which actual social contributions	14.6	14.4	14.5	14.7	14.7	14.7
Other revenue	5.0	4.9	5.0	4.9	5.0	5.0
Total expenditure	51.2	51.0	49.5	49.9	49.7	49.3
Collective consumption	8.6	8.4	8.2	8.2	8.2	8.1
Social benefits in kind	13.7	13.6	13.4	13.4	13.4	13.3
Social transfers other than in kind	17.6	17.5	17.3	17.6	17.8	17.8
Interest	2.9	2.8	3.0	3.1	3.1	3.1
Subsidies	1.2	1.4	1.4	1.3	1.2	1.2
Gross fixed capital formation	2.8	2.6	2.3	2.1	2.1	2.0
Other expenditures	4.4	4.7	3.8	4.2	3.9	3.8

Notes: Differences between the sum and the total of individual items are due to rounding.

Expenditure figures are corrected for the differences between the definition of expenditure according to ESA95 and according to EDP rules.

* Figure from Commission services' Spring 2013 forecast

Source: Commission services

Germany (where debt is expected to decline in 2013 and 2014) and Hungary (where debt is forecast to decline in 2014). Moreover, the debt-to-GDP ratio is projected to decline in Bulgaria, Denmark and Lithuania in 2013.

1.4. COMPOSITION OF ADJUSTEMENT

The fiscal consolidation policies conducted in the EU between 2009 and 2012 were mainly based on reducing expenditure, which fell by 1.7 pp of GDP, while revenues increased by 1.2 pp.

Table I.1.5: Government revenue and expenditure (% of the GDP)

	Revenue						Expenditure					
	2009	2010	2011	2012	2013*	2014*	2009	2010	2011	2012	2013*	2014*
BE	48.1	48.7	49.5	50.8	51.1	51.0	53.6	52.4	53.2	54.7	54.1	54.2
DE	45.1	43.6	44.5	45.2	45.2	45.1	48.2	47.7	45.3	45.0	45.4	45.1
EE	43.5	40.9	39.5	40.2	39.3	37.8	45.5	40.7	38.3	40.5	39.6	37.6
IE	34.7	35.2	34.9	34.6	34.8	35.0	48.6	66.1	48.2	42.2	42.3	39.4
EL	38.3	40.6	42.4	44.7	43.5	43.9	54.0	51.3	51.9	54.7	47.3	46.5
ES	35.1	36.6	35.7	36.4	36.8	35.9	46.3	46.3	45.1	47.0	43.3	42.9
FR	49.2	49.5	50.6	51.7	53.3	52.9	56.8	56.5	55.9	56.6	57.2	57.1
IT	46.5	46.1	46.2	47.7	48.2	47.7	52.0	50.5	50.0	50.7	51.1	50.2
LU	43.8	42.0	41.5	42.1	42.9	42.9	44.6	42.9	41.8	43.0	43.1	43.4
NL	45.8	46.1	45.4	46.4	47.3	47.2	51.4	51.3	49.9	50.4	50.9	50.8
AT	48.5	48.1	48.0	48.7	49.0	49.0	52.6	52.6	50.5	51.2	51.3	50.8
PT	39.6	41.6	45.0	41.0	43.1	42.6	49.7	51.5	49.4	47.4	48.6	46.6
SI	43.1	44.5	44.4	45.0	45.0	44.2	49.3	50.4	50.8	49.0	50.3	49.1
FI	53.4	53.0	53.9	53.7	54.5	55.2	55.9	55.5	54.7	55.6	56.3	56.7
MT	38.7	38.4	39.3	40.5	40.9	41.1	42.4	42.0	42.1	43.9	44.6	44.7
CY	40.1	40.9	39.7	40.0	40.6	39.1	46.2	46.2	46.0	46.3	47.1	47.5
SK	33.5	32.3	33.3	33.1	33.9	33.2	41.6	40.0	38.3	37.4	36.9	36.3
EA-17	44.9	44.8	45.3	46.2	46.8	46.5	51.2	51.0	49.5	49.9	49.7	49.3
BG	37.1	34.3	33.6	34.9	36.2	36.9	41.4	37.4	35.6	35.7	37.5	38.2
CZ	38.9	39.0	39.8	40.1	40.5	40.3	44.7	43.8	43.0	44.5	43.4	43.3
DK	55.3	55.0	55.7	55.5	56.1	54.1	58.0	57.5	57.5	59.5	57.8	56.8
LV	34.0	35.3	34.9	35.2	34.3	33.8	43.8	43.4	38.4	36.4	35.5	34.7
LT	35.5	35.2	33.3	32.9	32.6	32.4	44.9	42.4	38.8	36.1	35.6	34.8
HU	46.9	45.4	53.8	46.5	46.6	47.0	51.5	49.7	49.5	48.4	49.6	50.3
PL	37.2	37.6	38.4	38.4	37.6	36.9	44.6	51.5	49.4	47.4	48.6	46.6
RO	32.1	33.3	33.8	33.5	34.1	34.4	41.1	40.1	39.4	36.4	36.6	36.8
SE	54.0	52.3	51.2	51.3	51.2	51.2	54.7	52.0	51.0	51.8	52.2	51.5
UK	39.9	40.3	40.8	42.2	41.7	41.5	51.4	50.5	48.6	48.5	48.5	47.8
EU-27	44.2	44.1	44.7	45.4	45.8	45.5	51.1	50.6	49.1	49.4	49.2	48.8

Note: Differences between the sum of revenues and expenditures and the balance can be due to rounding

* Figure from Commission services' Spring 2013 forecast

Source: Commission services

Table I.1.6: Government structural revenue and expenditure (% of the GDP)

	Structural Revenue						Structural Expenditure					
	2009	2010	2011	2012	2013	2014	2009	2010	2011	2012	2013	2014
BE	48.3	48.7	49.6	50.4	50.8	51.0	52.2	52.0	53.1	53.4	53.1	53.3
DE	44.9	43.5	44.7	45.2	45.2	45.1	45.8	45.9	45.6	44.8	44.8	44.8
EE	41.0	38.6	38.9	40.2	39.3	37.9	42.1	39.7	39.5	40.0	39.4	37.8
IE	34.2	34.5	34.8	34.6	34.8	35.0	44.0	43.6	42.5	42.0	41.7	39.8
EL	38.4	40.0	41.8	43.6	42.8	43.4	53.2	48.8	47.1	44.6	40.7	41.4
ES	35.7	36.6	35.6	36.1	36.8	36.3	44.3	44.0	42.8	41.6	41.1	41.8
FR	49.1	49.5	50.4	51.6	52.9	52.9	55.1	55.3	55.1	55.1	55.2	55.2
IT	45.8	45.9	45.8	47.7	48.3	47.8	49.9	49.6	49.4	49.1	48.8	48.5
LU	43.9	42.0	41.6	42.2	43.0	43.0	42.9	42.1	41.2	42.1	42.2	42.7
NL	45.6	46.1	45.3	46.2	46.9	46.8	49.7	50.1	49.0	48.9	48.8	49.1
AT	48.3	48.0	48.0	48.6	48.8	48.9	51.0	51.3	50.3	50.1	50.4	50.6
PT	39.8	40.0	40.9	40.7	42.5	42.1	48.4	48.8	47.4	44.9	46.1	44.1
SI	43.0	44.4	44.4	44.7	44.9	44.1	47.3	49.1	49.0	47.4	47.2	47.4
FI	52.6	52.5	53.7	53.4	54.2	54.9	52.0	53.3	53.8	54.2	54.8	55.5
MT	38.1	37.8	38.9	40.3	40.8	41.1	42.0	42.4	42.5	44.4	44.6	44.8
CY	40.1	40.9	40.0	39.0	38.9	39.0	46.6	46.6	46.5	45.7	44.3	44.0
SK	33.1	32.2	32.8	32.8	32.9	32.5	40.3	39.4	38.1	37.0	35.9	35.0
EA-17	44.7	44.7	45.2	46.1	46.7	46.5	49.2	49.1	48.7	48.2	48.1	48.1
BG	36.9	34.1	33.5	34.9	36.1	36.8	40.4	36.2	35.1	35.2	36.9	37.6
CZ	38.8	38.7	39.6	40.0	40.3	40.1	44.2	43.2	42.6	41.6	41.9	42.2
DK	55.1	54.7	55.5	55.2	54.7	53.9	54.8	54.9	55.2	54.9	54.7	54.2
LV	32.8	34.2	34.3	35.1	34.4	33.9	37.8	37.1	35.9	35.4	35.8	35.4
LT	34.1	34.6	33.2	32.8	32.6	32.4	40.7	39.3	38.1	35.9	35.5	35.3
HU	46.5	44.5	43.4	45.6	46.3	46.8	48.9	47.8	47.5	46.4	47.4	48.7
PL	37.1	37.7	38.5	38.2	37.3	36.6	45.3	45.9	43.9	42.0	40.5	39.6
RO	32.1	33.2	33.8	33.4	33.9	34.2	41.6	39.4	37.8	36.1	35.6	35.6
SE	53.5	52.2	51.2	51.2	51.0	51.1	50.8	50.9	51.0	51.0	51.2	50.8
UK	39.9	40.3	40.8	40.4	41.6	41.5	49.3	49.2	47.6	47.3	47.3	46.9
EU-27	43.9	44.0	44.4	45.1	45.6	45.5	49.0	48.9	48.3	47.8	47.7	47.6

Source: Commission services

In the euro area, the composition was evenly distributed between expenditure and revenue, as expenditure fell by 1.3 pp and revenues increased by the same amount.

In 2012, the EU and the euro area saw both Revenue and expenditure ratios increase, although the latter only marginally.

In 2013, the revenue-to-GDP ratio is projected to increase again, of 45.8% and 46.8%, in the EU and in the euro area respectively. At the same time, expenditures are projected to continue declining in 2013 and 2014 (after a minor increase in 2012).

Table I.1.4 presents the main components of government revenue and spending for the euro area over 2009 to 2014. On the revenue side, social contributions appear as broadly stable over the period, while Member States are steadily raising indirect taxes, taxes on income and wealth, which are expected to have a less distortionary impact on growth.

On the expenditure side, public investment (as measured by the gross fixed capital formation in percentage of GDP) has experienced significant cuts. A deeper analysis of the composition of consolidation is conducted in Section I.2.5.

Table I.1.5 compares the revenue and expenditure ratios for all EU countries. According to the Commission 2013 Spring forecast, in most countries, both the revenue and the expenditure-to-GDP-ratios are forecast to remain broadly stable over the horizon. As exceptions to this average trend, the expenditure ratio is projected to decrease notably in Greece and Spain, while a particularly marked increase in the revenue ratio is forecast in Portugal, Finland and France.

Table I.1.6 shows that this general picture of the composition of fiscal consolidation does not change if are considered structural revenues and expenditures (i.e. cleaning out the effects of the cycle on expenditure, revenue and GDP at consideration for those ratios). However, this analysis allows detecting that in countries like Cyprus and Italy, structural expenditures are actually expected to decrease. This indicates that part of the effect observed in the decrease in the expenditure ratio is led by cyclical developments

of GDP rather than the behaviour of the expenditures.

2. IMPLEMENTATION OF FISCAL SURVEILLANCE

The EU fiscal framework, as laid down by the Stability and Growth Pact (SGP), aims at ensuring budgetary discipline through two main requirements. First, Member States are required by the Treaty to avoid excessive government deficit and debt positions, measured against reference values of 3% and 60% of GDP, respectively. ⁽¹⁾ Second, they are required by the preventive part of the SGP ⁽²⁾ to achieve and maintain their medium-term budgetary objectives (MTO), which are cyclically adjusted targets for the budget balance, net of one-off and temporary measures. Country-specific MTOs are set to secure the sustainability of public finances and to allow the automatic stabilizers to work without breaching the deficit thresholds required by the Treaty.

Following the marked deterioration of public finances in EU Member States in the wake of the severe economic recession of 2009, fiscal consolidation efforts started in 2010. They intensified in 2011 and 2012 and led to a significant improvement of public finance in both the EU and the euro area. Section I.1 discussed the strong corrections in government deficits that have already occurred.

The magnitude of the challenge faced means that despite those large efforts, sixteen EU Member States had government deficits exceeding the 3% of GDP reference value in 2012, based on data notified by Member States and validated by Eurostat. ⁽³⁾ On a more encouraging note, based on

the latest assessment of the Commission services, reflecting the 2013 Commission Spring forecast five countries appear to have brought their excessive deficits to below 3% of GDP in 2012, in a manner that can be considered durable, with one country's excess over the 3% limit being due to the implementation of pension reforms.

As indicated in Chapter I.1 according to the Commission 2013 Spring forecast, the estimated improvement of the structural budget balance in 2013 compared to 2012 is expected to be around ¾ pp of GDP both in the EU and in the euro area. The associated projected improvement of the budgetary situation in the EU is differentiated across Member States, with ten Member States forecast to see headline deficits increase in 2013. However this increase is only expected to be substantial in two cases. The deterioration in 2013 in Slovenia reflects a one-off conversion of hybrid debt-equity instruments into equity of the two largest banks, while the one in Hungary is expected to result from the expiration of one-offs from 2012 and a lasting correction of the deficit after 2013 seems to be assured by a recently-adopted package of measures.

In 2012 and 2013 the Commission and the Council adopted new EDP steps in the case of ten euro-area countries (Cyprus, Greece, Spain, Portugal, Malta, France, the Netherlands, Italy and Slovenia) and six non-euro area countries (Bulgaria, Hungary, Latvia, Lithuania, Romania and Poland). For three Member States (Bulgaria, Germany and Malta), the excessive deficit procedure was abrogated in 2012. In March and December 2012, following Commission recommendations, the Council issued two consecutive decisions amending its 12 July 2011 decision to give notice and to reinforce and deepen fiscal surveillance in Greece. Subsequently, in May 2013, the Commission issued a communication stating that Greece had taken effective action. In May 2013, the Council adopted a revised recommendation with regard to Cyprus and in June 2013 to Spain, France, the Netherlands, Poland, Portugal and Slovenia. Furthermore, also in June 2013, the Council stepped up the EDP issuing a decision to give notice with regard to Belgium and addressed a new EDP recommendation to Malta. At the same time, the Council issued decisions abrogating the

⁽¹⁾ Article 126 TFEU lays down an excessive deficit procedure (EDP) which is further specified in Council Regulation (EC) No. 1467/97 'on speeding up and clarifying the implementation of the excessive deficit procedure', amended in 2005 and 2011, which represents the corrective arm of the SGP. Relevant legal texts and guidelines can be found at: http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm

⁽²⁾ The preventive arm of the SGP is contained in Council Regulation (EC) No. 1466/97 'on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies', which was amended in 2005 and 2011. Together with Regulation (EC) No.1467/97 and the new Directive on requirements for budgetary frameworks of the Member States (Directive (EC) No. 2011/85) and Regulation (EU) No 1173/2011 on the effective enforcement of budgetary surveillance in the euro area, it forms the SGP.

⁽³⁾ This is somewhat worse than previously expected: in the Commission services' 2013 Winter forecast only fifteen countries were projected to exceed the 3% of GDP reference value.

decision on the existence of excessive deficit for Latvia, Romania, Italy, Lithuania and Hungary.

Currently, fifteen EU Member States are subjected to the EDP. Among the Member States subjected to the EDP, Greece, Portugal, Ireland and Cyprus are benefiting from financial assistance, ⁽⁴⁾ while the Balance of Payment (BoP) programme for Romania ended in June 2013 (see Box I.1.1). The excessive deficit procedure is currently in abeyance for all countries benefiting from financial assistance with the exception of Cyprus.

2.1. THE EXCESSIVE DEFICIT PROCEDURE (EDP)

This section focuses on the implementation of the EDP since January 2012. The historical country-specific developments are summarised in Tables I.2.1-I.2.3. ⁽⁵⁾

2.1.1. Euro-area Member States

On 11 January 2012, the Commission assessed the action taken by **Cyprus** in compliance with the July 2010 Council Recommendation to end the excessive deficit and concluded that effective action had been taken. However, following the unwinding of the very serious private and public sector imbalances in the Cypriot economy during 2012, the budget deficit turned out considerably worse than previously forecast. Taking into account the worse-than-expected economic downturn and the weaker overall position of the economy, on 7 May 2013, the Commission concluded that granting four additional years for the correction of the excessive deficit was warranted. Subsequently, on 16 May, the Council recommended that Cyprus put an end to the present excessive budget deficit situation by 2016 and established a deadline of three months for the Cypriot authorities to take effective action. Since March 2013, the excessive deficit procedure runs in parallel to the macroeconomic adjustment programme agreed between Cyprus and the Commission on behalf of the lenders, in liaison with the ECB and the IMF.

In the case of **Greece**, the excessive deficit procedure has run in parallel to the macroeconomic adjustment programmes since May 2010. ⁽⁶⁾ On 13 March 2012, the Council agreed to a second economic adjustment programme that had been negotiated by the Commission in December 2011 and January/February 2012. In the EDP context, the Commission further assessed, in March and November 2012, action taken in compliance with the amended May 2010 Council decision. Based on Commission recommendations, the Council adopted further amendments to its decision to give notice to the Greek authorities under Article 126(9) TFEU, in March and December 2012. In the latter one taking into account weaker-than-expected economic activity and acknowledging that Greece had taken effective action to remedy the situation of excessive deficit, the Council extended Greece's fiscal adjustment path by two years to 2016, revised the fiscal targets that Greece should respect in 2013 and 2014, and set new targets for 2015 and 2016.

On 30 May 2012, following **Germany's** first notification of government deficit and debt data for 2011 which reported that the deficit-to-GDP ratio returned well below the 3% of GDP reference value, and given that, according to the Commission services' 2012 spring forecast, it is expected to further improve over the forecast horizon, the Commission adopted a recommendation for a Council decision abrogating the decision on the existence of excessive deficit for Germany. On 22 June 2012, the Council decided to abrogate the excessive deficit procedure for Germany.

In **Spain**, an unexpected contraction of economic activity resulted in a strong deterioration of Spain's fiscal outlook in 2012. As a consequence, on 6 July 2012, the Commission concluded that an additional year for the correction of Spain's excessive deficit would be warranted. Subsequently, on 10 July, the Council recommended that Spain put an end to the present

⁽⁴⁾ Spain is also benefitting of financial assistance, but not in the context of a full-fledged programme.

⁽⁵⁾ All the country-specific developments regarding the excessive deficit procedure (EDP) can be followed at: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/index_en.htm

⁽⁶⁾ See Memorandum on Economic and Financial Policies and Memorandum of Understanding on Specific Economic Policy Conditionality (both 3 May 2010). All the documents related to the implementation of the EDP in the case of Greece can be found at: http://ec.europa.eu/economy_finance/sgp/deficit/countries/greece_en.htm

Table I.2.1: Overview EDP steps - Euro area Member States

Steps in EDP procedure	Treaty Art.	Country														
		IE	FR	ES	MT	BE	DE	IT	NL	AT	PT	SI	SK	CY	FI	
Starting phase																
Commission adopts EDP-report = start of the procedure	126(3)	18.02.2009	18.02.2009	18.02.2009	13.05.2009	07.10.2009	07.10.2009	07.10.2009	07.10.2009	07.10.2009	07.10.2009	07.10.2009	07.10.2009	07.10.2009	12.5.2010	12.5.2010
Economic and Financial Committee adopts opinion	126(4)	27.02.2009	27.02.2009	27.02.2009	29.05.2009	27.10.2009	27.10.2009	27.10.2009	27.10.2009	27.10.2009	27.10.2009	27.10.2009	27.10.2009	27.10.2009	27.5.2010	27.5.2010
Commission adopts: opinion on existence of excessive deficit	126(5)	24.03.2009	24.03.2009	24.03.2009	24.06.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	15.6.2010	15.6.2010
recommendation for Council decision on existence of excessive deficit	126(6)	24.03.2009	24.03.2009	24.03.2009	24.06.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	15.6.2010	15.6.2010
recommendation for Council recommendation to end this situation	126(7)	24.03.2009	24.03.2009	24.03.2009	24.06.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	15.6.2010	15.6.2010
Council adopts: decision on existence of excessive deficit	126(6)	27.04.2009	27.04.2009	27.04.2009	07.07.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	13.7.2010	13.7.2010
recommendation to end this situation	126(7)	27.04.2009	27.04.2009	27.04.2009	07.07.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	13.7.2010	13.7.2010
deadline for taking effective action	126(7)	27.10.2009	27.10.2009	27.10.2009	07.01.2010	02.06.2010	02.06.2010	02.06.2010	02.06.2010	02.06.2010	02.06.2010	02.06.2010	02.06.2010	02.06.2010	13.01.2011	13.01.2011
fiscal effort recommended by the Council*		at least 1.5% of GDP in 2010-2013	at least 1% of GDP in 2010-2012	1% of GDP in 2010-2012	-	3% of GDP in 2010-2012	at least 0.5% of GDP in 2010-2013	at least 0.5% of GDP in 2010-2012	3% of GDP in 2011-2013	3% of GDP in 2011-2013	13% of GDP in 2010-2013	3% of GDP in 2010-2013	1% of GDP in 2010-2013	1% of GDP in 2011-2012	at least 0.5% of GDP in 2011-2012	at least 0.5% of GDP in 2011
deadline for correction of excessive deficit		2013	2012	2012	2010	2012	2013	2012	2013	2013	2013	2013	2013	2013	2012	2011
Follow-up of the Council recommendation under Art. 126(7)																
Commission adopts communication on action taken		-	-	-	-	15.06.2010	15.06.2010	15.06.2010	15.06.2010	15.06.2010	15.06.2010	15.06.2010	15.06.2010	15.06.2010	27.01.2011	27.01.2011
Council adopts conclusions thereon		-	-	-	-	13.07.2010	13.07.2010	13.07.2010	13.07.2010	13.07.2010	13.07.2010	13.07.2010	13.07.2010	13.07.2010	15.02.2011	15.02.2011
Commission adopts recommendation for NEW Council recommendation to end situation of excessive deficit	126(7)	11.11.2009	11.11.2009	11.11.2009	27.01.2010											
Council adopts recommendation for NEW Council recommendation to end situation of excessive deficit	126(7)	02.12.2009	02.12.2009	02.12.2009	16.02.2010											
deadline for taking effective action		02.06.2010	02.06.2010	02.06.2010	16.08.2010											
fiscal effort recommended by the Council*		2% of GDP in 2010-2014	above 1% of GDP in 2010-2013	above 1.5% of GDP in 2010-2013	3% of GDP in 2011											
revised deadline for correction of excessive deficit		2014	2013	2013	2011											
Follow-up of the NEW Council recommendation under Art. 126(7)																
Commission adopts communication on action taken		15.06.2010	15.06.2010	15.06.2010	06.01.2011	11.01.2012									11.01.2012	
Council adopts conclusions thereon		13.07.2010	13.07.2010	13.07.2010	18.01.2011											
Commission adopts recommendation for Council decision establishing inadequate action	126(8)	-	-	-	-											
Council adopts decision establishing inadequate action	126(8)	-	-	-	-											
Commission adopts recommendation for NEW Council recommendation to end situation of excessive deficit	126(7)	03.12.2010		06.07.2012							27.09.2012			07.05.2013		
Council adopts recommendation for NEW Council recommendation to end situation of excessive deficit	126(7)	07.12.2010		10.07.2012							09.10.2012			16.05.2013		
deadline for taking effective action		07.06.2011		10.10.2012							09.01.2013			16.08.2013		
fiscal effort recommended by the Council*		9% of GDP over 2011-2015		7% of GDP over 2012-2014							5% of GDP over 2012-2014			**		
new deadline for correction of excessive deficit		2015		2014							2014			2016		
Follow-up of the NEW Council recommendation under Art. 126(7)																
Commission adopts communication on action taken		24.08.2011		14.11.2012												
Council adopts conclusions thereon		02.09.2011		04.12.2012												
Commission adopts recommendation for Council decision establishing inadequate action																
Commission adopts recommendation for NEW Council recommendation to end situation of excessive deficit			29.05.2013	29.05.2013	29.05.2013	29.05.2013				29.05.2013		29.05.2013	29.05.2013			
Council adopts recommendation for NEW Council recommendation to end situation of excessive deficit			21.06.2013	21.06.2013	21.06.2013	21.06.2013				21.06.2013		21.06.2013	21.06.2013			
deadline for taking effective action																
fiscal effort recommended by the Council*																
new deadline for correction of excessive deficit			2015	2016	2014					2016		2015	2015			
Abrogation																
Commission adopts recommendation for Council decision abrogating existence of excessive deficit	126(12)				14.11.2012			30.05.2012	29.05.2013							29.06.2012
Council adopts decision abrogating existence of excessive deficit	126(12)				04.12.2012			22.06.2012	21.06.2013							12.07.2011

Notes: * Average annual fiscal effort, unless indicated otherwise. ** Recommendations for Cyprus are expressed in terms of the nominal value of expected consolidation measures. Cyprus should rigorously implement the 2013 Budget Law and the agreed additional consolidation measures, which should amount to at least EUR 351 million in 2013. Cyprus should fully implement the fiscal measures for 2014 that were adopted in December 2012, amounting to at least 270 million EUR in 2014.

Source: Commission services

excessive budget deficit situation by 2014 and established a deadline of three months for the Spanish authorities to take effective action. On 29 May 2013, the Commission found that Spain had taken effective action, but given adverse economic events and a set of unfavourable factors it was not expected to meet the nominal budgetary targets. Consequently, on 21 June 2013, the Council, on recommendation by the Commission, issued a revised recommendation, extending the deadline to correct the excessive deficit by 2016.

On 27 September 2012, the Commission assessed the action taken by **Portugal** in compliance with the December 2009 Council Recommendation to end the excessive deficit and concluded that effective action had been taken. Taking into account that the Portuguese economy had been hit by unexpected events leading to a worse-than-

expected economic outlook, the Commission recommended granting an additional year for the correction of the excessive deficit. Subsequently, on 9 October 2012, the Council recommended that Portugal put an end to the present excessive budget deficit situation by 2014 and established a deadline of three months for the Portuguese authorities to take effective action. On 29 May 2013, the Commission concluded that Portugal had taken effective action, but given adverse economic events and a set of unfavourable factors, it was not expected to meet the nominal budgetary targets. Consequently, on 21 June 2013, the Council issued a revised recommendation, extending the deadline to correct the excessive deficit by 2015.

On 14 November 2012, following **Malta's** notification of a general government deficit of below 3% of GDP in 2011, the Commission

concluded that effective action had been taken to end the excessive deficit within the deadline established in the July 2009 Council Recommendation. Subsequently, on 27 November 2012, the Council thus agreed that the excessive deficit in Malta had been corrected and decided to close Malta's excessive deficit procedure. However, already a few months later, following the notification by Malta of a deficit in excess of 3% of GDP in 2012, the Council issued, on 21 June 2013, a recommendation to put an end to the present excessive deficit situation in Malta by 2014.

On the basis of **Italy's** 2013 Spring notification of government deficit data and of the Commission 2013 Spring forecast, the Commission adopted a recommendation for a Council decision to abrogate the decision on the existence of an excessive deficit on 29 May 2013. On 21 June 2013, the Council decided to close the excessive deficit procedure for Italy.

In the case of **Belgium**, following a recommendation by the Commission, on 21 June 2013, the Council issued a decision establishing that Belgium had not corrected its excessive deficit by the deadline in 2012 and had not taken effective action in response to the Council recommendation. This decision was followed by a decision to give notice to take measures for the deficit reduction judged necessary in order to remedy the situation of excessive deficit by 2013.

Also on 21 June 2013, following a recommendation by the Commission, the Council assessed that **France**, the **Netherlands** and **Slovenia** were not expected to correct their excessive deficits by the deadline in 2013, but were projected to deliver effective action and therefore fulfilled the conditions for the extension of the deadline. Accordingly, Council recommended France and Slovenia to correct their excessive deficits by 2015 and the Netherlands by 2014.

2.1.2. Non-euro area Member States

Table I.2.1 shows the EDP steps taken for the non-euro area countries.

On 24 January 2012, the Council decided that **Hungary** had not complied with its previous

recommendations. The Council followed a recommendation from the Commission which had concluded that Hungary had not taken effective action in response to the July 2009 Council recommendation to correct its excessive deficit in a sustainable manner by 2011. Consequently, on 13 March 2012, the Council followed a recommendation from the Commission and addressed a new recommendation to Hungary, requiring the country to correct the excessive deficit in 2012. ⁽⁷⁾ On 30 May 2012, the Commission concluded that Hungary had made adequate progress towards a timely correction of the excessive deficit, in response to the March 2012 Council recommendation to bringing an end to the excessive deficit situation, and that no further EDP steps were needed. ⁽⁸⁾ On 21 June 2013, based on the Spring 2013 EDP notification which showed that the excessive deficit had been brought below 3% of GDP in 2012 and following the implementation by the Hungarian authorities of a set of additional measures assuring the durable nature of the correction, the Council issued a decision abrogating the decision on the existence of excessive deficit.

On the basis of Bulgaria's first notification of government deficit and debt data for 2011 and of the Commission 2012 Spring forecast, the Commission adopted a recommendation for a Council decision to abrogate the decision on the existence of an excessive deficit on 30 May 2012. On 22 June 2012, the Council decided to abrogate the excessive deficit procedure for Bulgaria.

Likewise, the Commission assessed 2013 government deficit and debt data provided by Latvia, Lithuania and Romania against its 2013 Spring forecast and adopted a recommendation for a Council decision to abrogate the decision on the

⁽⁷⁾ On the same date, the Council also adopted a decision suspending almost a third of scheduled commitments for Hungary from the EU Cohesion Fund in 2013, taking recourse, for the first time, to the possibility of suspending cohesion fund commitments in case of non-compliance with its EDP recommendation under Article 126(7) of the Treaty, according to Article 4(1) of Regulation (EC) No 1084/2006

⁽⁸⁾ On the same date, the Commission also adopted a proposal for a Council decision to lift the suspension of the commitments from the Cohesion Fund Article 4(2) of Regulation (EC) No 1084/2006 establishing the conditions for lifting the suspension for the Cohesion Fund commitments, which the Council adopted on 19 June 2012.

Table I.2.2: Overview EDP steps - Non-euro area Member States

Steps in EDP procedure	Treaty Art.	Country									
		HU	UK	LV	PL	LT	RO	CZ	BG	DK	
Starting phase											
Commission adopts EDP-report = start of the procedure	126(3)	12.05.2004	11.6.2008	18.02.2009	13.05.2009	13.05.2009	13.05.2009	07.10.2009	12.05.2010	12.05.2010	
Economic and Financial Committee adopts opinion	126(4)	24.05.2004	25.6.2008	27.02.2009	29.05.2009	29.05.2009	29.05.2009	27.10.2009	27.05.2010	27.05.2010	
Commission adopts:											
opinion on existence of excessive deficit	126(5)	24.06.2004	02.07.2008	02.07.2009	24.06.2009	24.06.2009	24.06.2009	11.11.2009	06.07.2010	15.06.2010	
recommendation for Council decision on existence of excessive deficit	126(6)	24.06.2004	02.07.2008	02.07.2009	24.06.2009	24.06.2009	24.06.2009	11.11.2009	06.07.2010	15.06.2010	
recommendation for Council recommendation to end this situation	126(7)	24.06.2004	02.07.2008	02.07.2009	24.06.2009	24.06.2009	24.06.2009	11.11.2009	06.07.2010	15.06.2010	
Council adopts:											
decision on existence of excessive deficit	126(6)	05.07.2004	08.07.2008	07.07.2009	07.07.2009	07.07.2009	07.07.2009	02.12.2009	13.07.2010	13.07.2010	
recommendation to end this situation	126(7)	05.07.2004	08.07.2008	07.07.2009	07.07.2009	07.07.2009	07.07.2009	02.12.2009	13.07.2010	13.07.2010	
deadline for taking effective action		05.11.2004	08.01.2009	07.01.2010	07.01.2010	07.01.2010	07.01.2010	02.06.2010	13.01.2011	13.01.2011	
fiscal effort recommended by the Council*		-	at least 0.5% of GDP in 2009/10	at least 2¼% of GDP in 2010-2012	at least 1¼% of GDP in 2010-2012	at least 1½% of GDP in 2009-2011	at least 1½% of GDP in 2010-2011	1% of GDP in 2010-2013	at least ¾% of GDP in 2011	at least 0.5% of GDP in 2011-2013	
deadline for correction of excessive deficit		2008	fin. year 2009/10	2012	2012	2011	2011	2013	2011	2013	
Follow-up of the Council recommendation under Art. 126(7)											
Commission adopts communication on action taken		-	-	27.01.2010	03.02.2010	-	-	15.06.2010	27.01.2011	27.01.2011	
Council adopts conclusions thereon		-	-	16.02.2010	16.02.2010	-	-	13.07.2010	15.02.2011	15.02.2011	
Commission adopts recommendations for Council decision establishing inadequate action	126(8)	22.12.2004	24.03.2009								
Council adopts decision establishing inadequate action	126(8)	18.01.2005	27.04.2009								
Commission adopts recommendation for NEW Council recommendation to end excessive deficit situation	126(7)	16.02.2005	24.03.2009			27.01.2010	08.02.2010				
Council adopts NEW recommendation to end excessive deficit situation	126(7)	08.03.2005	27.04.2009			16.02.2010	16.02.2010				
deadline for taking effective action		08.07.2005	27.10.2009			16.08.2010	16.08.2010				
fiscal effort recommended by the Council*		-	beyond 1% of GDP in 2010/11-2013/14			at least 2¼% of GDP in 2010-2012	1¾% of GDP in 2010-2012				
new deadline for correction of excessive deficit		2008	fin. year 2013/14			2012	2012				
Follow-up of the NEW Council recommendation under Art. 126(7)											
Commission adopts communication on action taken		13.07.2005	-		11.01.2012	21.09.2010	21.09.2010				
Council adopts conclusions thereon		-	-			19.10.2010	19.10.2010				
Commission adopts recommendations for Council decision establishing inadequate action	126(8)	20.10.2005	-								
Council adopts decision establishing inadequate action	126(8)	08.11.2005	-								
Commission adopts recommendation for NEW Council recommendation to end excessive deficit situation	126(7)	26.09.2006	11.11.2009								
Council adopts NEW recommendation to end excessive deficit situation	126(7)	10.10.2006	02.12.2009								
deadline for taking effective action		10.04.2007	02.06.2010								
fiscal effort recommended by the Council*		-	1¾% of GDP in 2010/11-2014/15								
new deadline for correction of excessive deficit		2009	fin. year 2014/15								
Follow-up of the NEW Council recommendation under Art. 126(7)											
Commission adopts communication on action taken		13.06.2007	06.07.2010		29.05.2013	21.06.2013					
Council adopts conclusions thereon		10.07.2007	13.07.2010								
Commission adopts recommendations for Council decision establishing inadequate action	126(8)	-	-								
Council adopts decision establishing inadequate action	126(8)	-	-								
Commission adopts recommendation for NEW Council recommendation to end excessive deficit situation	126(7)	24.06.2009									
Council adopts NEW recommendation to end excessive deficit situation	126(7)	07.07.2009									
deadline for taking effective action		07.01.2010									
fiscal effort recommended by the Council*		0.5% of GDP in cumulative terms in 2010-2011			2014						
new deadline for correction of excessive deficit		2011									
Follow-up of the NEW Council recommendation under Art. 126(7)											
Commission adopts communication on action taken		27.01.2010									
Council adopts conclusions thereon		16.02.2010									
Commission adopts recommendations for Council decision establishing inadequate action	126(8)	11.01.2012									
Council adopts decision establishing inadequate action	126(8)	24.01.2012									
Commission adopts recommendation for NEW Council recommendation to end excessive deficit situation	126(7)	06.03.2012									
Council adopts NEW recommendation to end excessive deficit situation	126(7)	13.03.2012									
deadline for taking effective action		13.09.2012									
fiscal effort recommended by the Council		at least 0.5% of GDP on top of the 1.9% of GDP foreseen									
new deadline for correction of excessive deficit		2012									
Follow-up of the NEW Council recommendation under Art. 126(7)											
Commission adopts communication on action taken		30.05.2012									
Council adopts conclusions thereon											
Abrogation											
Commission adopts recommendation for Council decision abrogating existence of excessive deficit	126(12)	29.05.2013		29.05.2013		29.05.2013	29.05.2013		30.05.2012		
Council adopts decision abrogating existence of excessive deficit	126(12)	21.06.2013		21.06.2013		21.06.2013	21.06.2013		22.06.2012		

Notes: * Average annual fiscal effort, unless indicated otherwise.

Source: Commission services

Table I.2.3: Overview EDP steps - Greece

Steps in EDP procedure	Treaty Art.	EL
Starting phase		
Commission adopts EDP-report = start of the procedure	126(3)	18.02.2009
Economic and Financial Committee adopts opinion	126(4)	27.02.2009
Commission adopts:		
opinion on existence of excessive deficit	126(5)	24.03.2009
recommendation for Council decision on existence of excessive deficit	126(6)	24.03.2009
recommendation for Council recommendation to end this situation	126(7)	24.03.2009
Council adopts:		
decision on existence of excessive deficit	126(6)	27.04.2009
recommendation to end this situation	126(7)	27.04.2009
deadline for taking effective action		27.10.2009
fiscal effort recommended by the Council		-
deadline for correction of excessive deficit		2010
Follow-up of the Council recommendation under Art. 126(7)		
Commission adopts recommendations for Council decision establishing inadequate action	126(8)	11.11.2009
Council adopts decision establishing inadequate action	126(8)	02.12.2009
Commission adopts Council recommendation for decision to give notice	126(9)	03.02.2010
Council decision to give notice	126(9)	16.02.2010
deadline for taking effective action		15.05.2010
fiscal effort recommended by the Council		at least 3¼% of GDP annually in 2010 and 2011, at least 2¼% of GDP in 2012
new deadline for correction of the excessive deficit		2012
Follow-up of the Council decision		
Commission adopts communication on action taken		09.03.2010
Council adopts conclusions thereon		16.03.2010
Commission adopts recommendation for NEW Council decision to give notice	126(9)	04.05.2010
Council decision to give notice	126(9)	10.05.2010
fiscal effort recommended by the Council		at least 10% in cumulative terms over 2009-2014
new deadline for correction of the excessive deficit		2014
Follow-up - 1st review		
Commission adopts communication on action taken		19.08.2010
Council adopts conclusions thereon		07.09.2010
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	19.08.2010
Council decision amending the Council decision to give notice	126(9)	07.09.2010
new deadline for correction of the excessive deficit		2014
Follow-up - 2nd review		
Commission adopts communication on action taken		09.12.2010
Council adopts conclusions thereon		20.12.2010
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	09.12.2010
Council decision amending the Council decision to give notice	126(9)	20.12.2010
deadline for correction of the excessive deficit		2014
Follow-up - 3rd review		
Commission adopts communication on action taken		24.02.2011
Council adopts conclusions thereon		07.03.2011
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	24.02.2011
Council decision amending the Council decision to give notice	126(9)	07.03.2011
deadline for correction of the excessive deficit		2014
Follow-up - 4th review		
Commission adopts communication on action taken		01.07.2011
Council adopts conclusions thereon		12.07.2011
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	05.07.2011
Council decision amending the Council decision to give notice	126(9)	12.07.2011
deadline for correction of the excessive deficit		2014
Follow-up - 5th review		
Commission adopts communication on action taken		26.10.2011
Council adopts conclusions thereon		08.11.2011
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	26.10.2011
Council decision amending the Council decision to give notice	126(9)	08.11.2011
deadline for correction of the excessive deficit		2014
Follow-up - Second Adjustment Programme		
Commission adopts communication on action taken		09.03.2012
Council adopts conclusions thereon		13.03.2012
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	09.03.2012
Council decision amending the Council decision to give notice	126(9)	13.03.2012
deadline for correction of the excessive deficit		2014
Follow-up - Second Adjustment Programme		
Commission adopts communication on action taken		30.11.2012
Council adopts conclusions thereon		03.12.2012
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	30.11.2012
Council decision amending the Council decision to give notice	126(9)	04.12.2012
fiscal effort recommended by the Council		*
new deadline for correction of the excessive deficit		2016

Notes: * In the case of Greece, targets are expressed as the cyclically-adjusted-primary-balance-to-GDP ratio and as the cyclically-adjusted-government-deficit-to-GDP ratio. These targets are an improvement in the cyclically-adjusted-primary-balance-to-GDP ratio from 4,1 % in 2012 to 6,2 % in 2013 and at least 6,4 % of GDP in 2014, 2015 and 2016 and a cyclically-adjusted-government-deficit-to-GDP ratio at -1,3 % in 2012, 0,7 % in 2013, 0,4 % in 2014, 0,0 % in 2015 and -0,4 % in 2016, reflecting the original profile of interest payments.

Source: Commission services

existence of an excessive deficit on 29 May 2013. Following the recommendation of the Commission, on 21 June 2013, the Council issued a decision which closed the excessive deficit procedure for these three countries. Based on the Spring 2013 EDP notification, on 21 June 2013, the Council assessed that **Poland** had not corrected its excessive deficits by the deadline in 2012, but had delivered effective action and therefore fulfilled the conditions for the extension of the deadline. Accordingly, through a revised recommendation, Council recommended Poland to correct its excessive deficit by 2014.

2.2. STABILITY AND CONVERGENCE PROGRAMME

This section provides an overview of the Stability and Convergence Programmes (SCPs) that Member States submitted in April-May 2013, outlining their fiscal policy plans for the 2013 to 2016.⁽⁹⁾ The SCPs are submitted as part of the European Semester. It aims at offering a global, aggregated view of fiscal policy plans in the Union and the euro area as a whole.

In its conclusions of 15 March 2013, the Council indicated that fiscal consolidation has to be pursued and should be differentiated, growth-friendly, in line with the priorities set out in the Annual Growth Survey, and based on an appropriate mix of expenditure and revenue measures at the level of the Member States. Together with the Stability and Growth Pact requirements, these principles represent the basis for the assessments of the SCPs and the Council recommendations in the context of the European Semester. These are expected to feed into the national budgets for 2014. This year is the first year when the implementation of the plans for the next year will be reviewed in Autumn with the introduction of the Commission's assessments of the draft budgetary plans following the entry into force of the Two Pack in May 2013 (see Part II).

⁽⁹⁾ Greece and Cyprus did not submit an SCP, which is subsumed under the Memorandum of Understanding (see Box I.1.1).

2.2.1. Macroeconomic scenarios

On average, macroeconomic scenarios presented in the SPCs for 2013-2014 are marginally more optimistic if compared to the Commission forecasts, although the overall picture – a still subdued economic environment this year and a recovery next year – is similar. For the EU as a whole, growth is expected to be just 0.1% in 2013 and 1.5% in 2014.

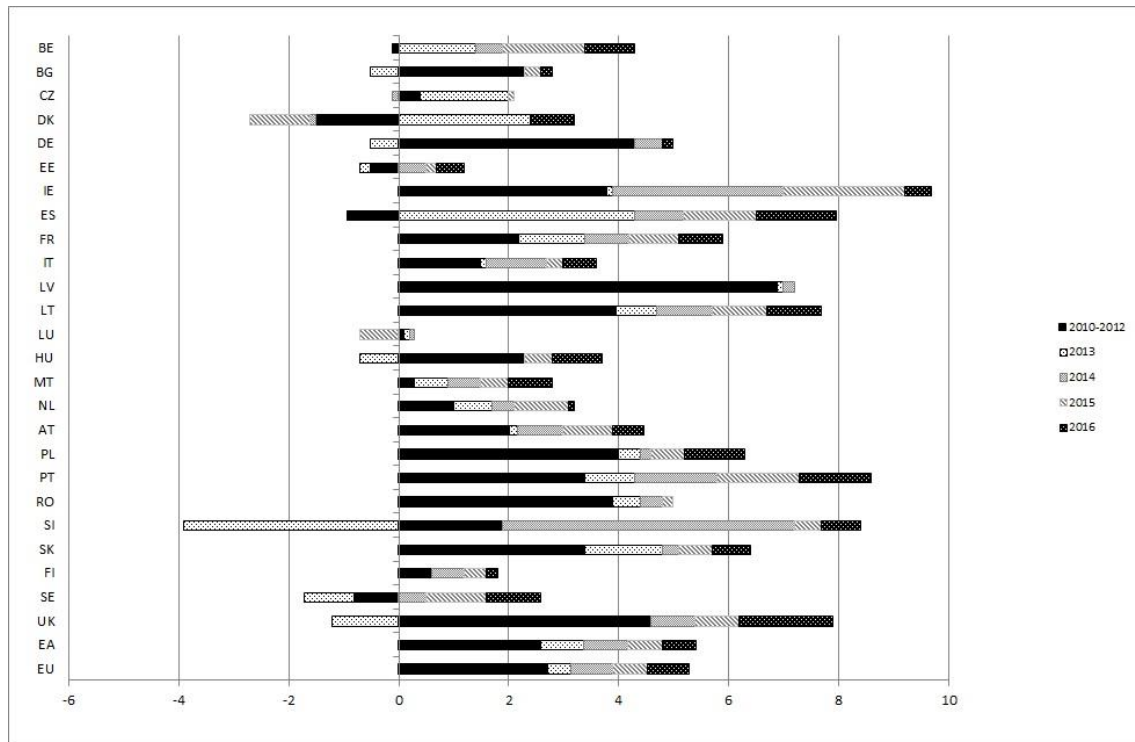
With such low growth the negative output gap is forecast to continue to widen in 2013 and before starting to close in both the EU and in the euro area from 2014. In both regions, the output gap will not close by 2016, according to the Member States' plans. Negative output gaps prevail in nearly all Member States over the programme period. The only exceptions are the Baltic countries, which have positive and increasing output gaps over the whole programme horizon.

In 2013 the external sector is forecast to be the only growth driver in both the EU and the euro area, with investment putting the largest drag on growth. This pattern is expected to change next year, when a strong pick up in investment is planned to be the main driver of the recovery supported by improving private consumption. At the same time, government consumption is expected to continue weighing negatively on growth in both years.

The programmes are more optimistic than the Commission regarding the contribution of investment to growth, in particular for this year, but also for 2014. On the contrary, the programmes are rather cautious in their expectations about government consumption, in particular for 2014, compared to the Commission 2013 Spring forecast.

Optimistic assumptions throughout the period, as measured by comparison to the Commission 2013 Spring forecast, characterize the programmes of Hungary, Poland, and the Netherlands. Also Italy, Luxembourg and Finland have more optimistic growth forecast for 2014. On the other hand, in Sweden the macroeconomic assumptions are more cautious than the Commission 2013 Spring forecast for both 2013 and 2014.

Graph I.2.1: **Time profile of fiscal consolidation: the change in nominal budget deficits in EU Member States over 2010-12 and plans, as presented in 2013 updates of SCPs**



The graph decomposes the change in the deficit-to-GDP ratio for each country over five time periods

Source: Commission services

The recovery in private consumption and investment foreseen in the programmes in 2014 is associated with an acceleration in imports, but with an even stronger export dynamics, the aggregated programme scenario results in a continuous improvement of the external position⁽¹⁰⁾ of the EU and the euro area throughout the period. With broadly stable terms of trade, improvements in external position imply that Member States' plans assume persistent positive differences between external and internal demand over the programme horizon. In the euro area, only in Estonia would the external position deteriorate and fall into a small deficit from 2015 on, while in Germany the external surplus is reduced slightly over the programme horizon. Among Member States that project large improvements in their external position, Spain and Malta see small surpluses continue rising over the programme period, while the already large surplus

in the Netherlands is projected to grow further. If the programme scenarios were to materialize, the external position of the euro area would exceed 3% of GDP towards the end of the programme horizon, with an improvement of more than 3pp of GDP compared to 2007.

2.2.2. Fiscal consolidation

2.2.2.1 Size and time profile of planned consolidation

After achieving significant improvements of their structural balances in 2012,⁽¹¹⁾ Member States plan to continue consolidating with aggregate deficits falling every year, albeit at a slightly lower annual pace than in recent years (see Graph I.2.1).

The EU deficit should fall roughly by around 2½pp of GDP from its 2012 level to reach 1.2% in 2016, coming in below 3% of GDP in 2014 for the

⁽¹⁰⁾ The external position is defined as net lending towards the rest of the world and it comprises the current account and transfers received.

⁽¹¹⁾ In the EU as a whole the structural budget balance improved by 1.1pps in 2012; in the EA, by 1.5pps.

first time since 2008. At euro area level, the deficit should fall from 3.6% of GDP in 2012 to 0.8% in 2016, coming in below 3% already this year. The continuing consolidation planned means that while in 2012 fourteen⁽¹²⁾ of the Member States for which SCP data is available had deficits above 3% of GDP, six of these Member States⁽¹³⁾ plan for their deficits to fall below 3% in 2013. By 2016, only the United Kingdom is projecting a nominal deficit above the 3% Treaty reference value. The lower annual pace of deficit reduction for future years reflects the fact that more and more countries are exiting the EDP and moving over to the preventive arm of the SGP.

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Graph I.2.1 shows the evolution in nominal balances from 2010 to 2016. It shows that on aggregate large reductions in deficits have already been undertaken with the deficits falling by over 1% of GDP per year between 2010 and 2012 in both the EU and euro area. Hence around half of the planned EU and euro area deficit reduction has already occurred, with the remaining half being spread over twice as many years. The improvements in the balances pencilled in for 2013-2016 are based on slightly easier economic conditions and should therefore be delivered with a lower burden of measures.

The pattern of the closure of the deficits over time is broadly differentiated according to the different circumstances that Member States have found themselves in. Countries with the largest deficits in

2010 and the least fiscal space are typically those that have already undertaken the greatest reduction of their deficit. On the other hand, countries with more fiscal space typically had both smaller reductions to make and less pressure to deliver them quickly.

2.2.2.2 Evolution of structural balances and convergence towards the MTO

Over the SCPs horizon, the Member States generally plan continuous consolidation until the achievement of their medium-term budgetary objective (MTO). Over the last two years structural balances in the EU and the euro area have undergone significant adjustments. According to the SCPs, structural balances would continue to improve, though at a relatively more moderate pace in 2013 and 2014, followed by a further slowdown of the pace of consolidation in 2015 and 2016. Considering the overall adjustment period from 2010 until 2016, Graph I.2.2 shows that about three quarters of the cumulative improvement would have taken place by the end of 2013, thus indicating that the adjustment has been relatively frontloaded, in particular in the euro area. The cumulative changes in the structural balance of the general government over 2010 to 2016 are presented in Graph I.2.2.

The improvements foreseen by the 2013 SCPs, while remaining significant, have been somewhat scaled down compared to those announced in the 2012 SCPs. Member States have downsized the planned adjustments for 2013, given the progress made, as several countries have corrected the excessive deficit in 2011, while others have been given more time to do so, as the recommended effort had been implemented and in view of continuously less favourable macroeconomic conditions than forecast over the past years. Indeed, the negative output gap, in both the EU and the euro area, instead of slowly shrinking as envisaged in 2012 SCPs, is significantly widening in 2013. The combination of a still significant structural adjustment and a widening negative output gap between 2012 and 2013 leads, again, to a pro-cyclical fiscal stance in 2013.

According to the SCPs, consolidation should continue in 2014 with an annual adjustment set at about 0.5pp of GDP in both the EU and the euro area. Structural adjustments are planned to

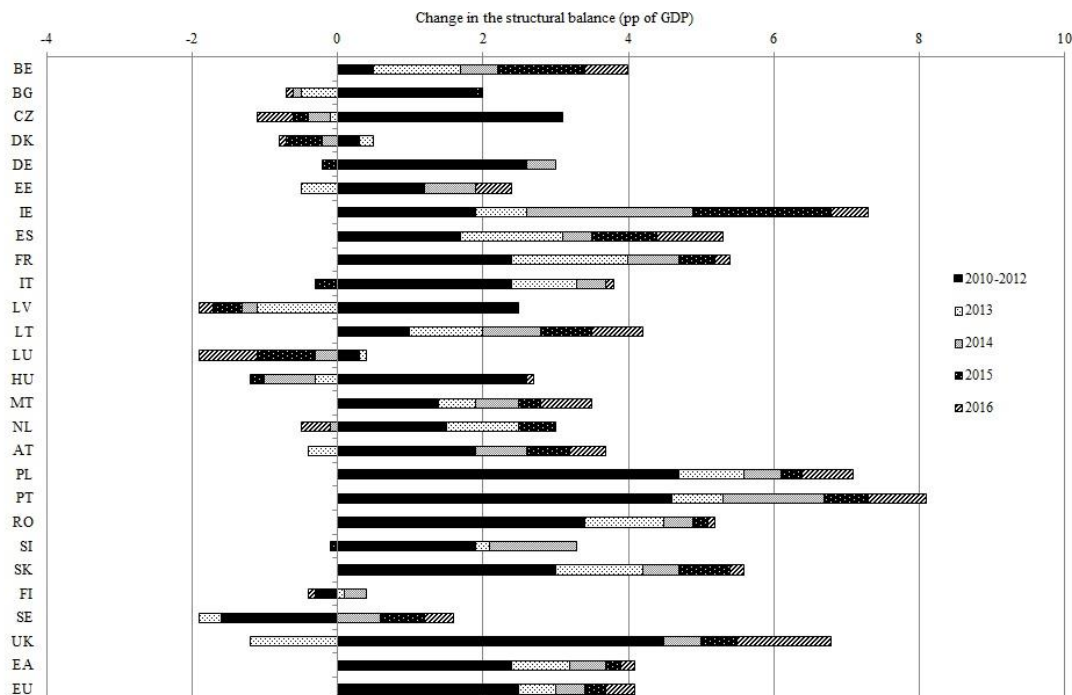
⁽¹²⁾ Greece and Cyprus did not submit their SCPs (see previous footnote.)

⁽¹³⁾ Belgium, Czech Republic, Denmark, Lithuania, Malta, Slovakia.

⁽¹⁴⁾ Belgium, Czech Republic, Denmark, Ireland, Spain, France, Lithuania, Malta, Netherlands, Poland, Portugal, Slovenia, Slovakia, United Kingdom.

⁽¹⁵⁾ Belgium, Czech Republic, Denmark, Lithuania, Malta, Slovakia.

Graph I.2.2: The change in structural budget balances over 2010-12 (cumulative, notified) and plans from 2013 to 2016 (as presented in 2013 SCPs) in the EU Member States



This graph presents the 2012-2010 structural effort achieved by Member States based on the 2010 estimate of the structural balance by the Commission 2013 Spring forecast and the (recalculated) 2012 estimate presented by the Member States in 2013 SCPs. Starting from 2012, structural efforts are directly reported from the SCPs, using the commonly agreed methodology to recalculate structural balances.

Source: Commission services

continue thereafter and until 2016, albeit at a moderate pace. The structural deficits should therefore reach 0.8% of GDP in the EU and 0.4% of GDP in the euro area by the end of 2016.

While more than three quarters of the Member States plan a strengthening of their fiscal position over the period, there are substantial differences in terms of pace and timeline. The cumulated size of the structural adjustment tends to be related to the starting position of the Member States with a generally larger adjustment when the structural deficit is initially higher. This confirms the functioning of the differentiated fiscal strategy, which foresees a modulation of the fiscal effort to the fiscal space, in line with the guidance of the European Council.

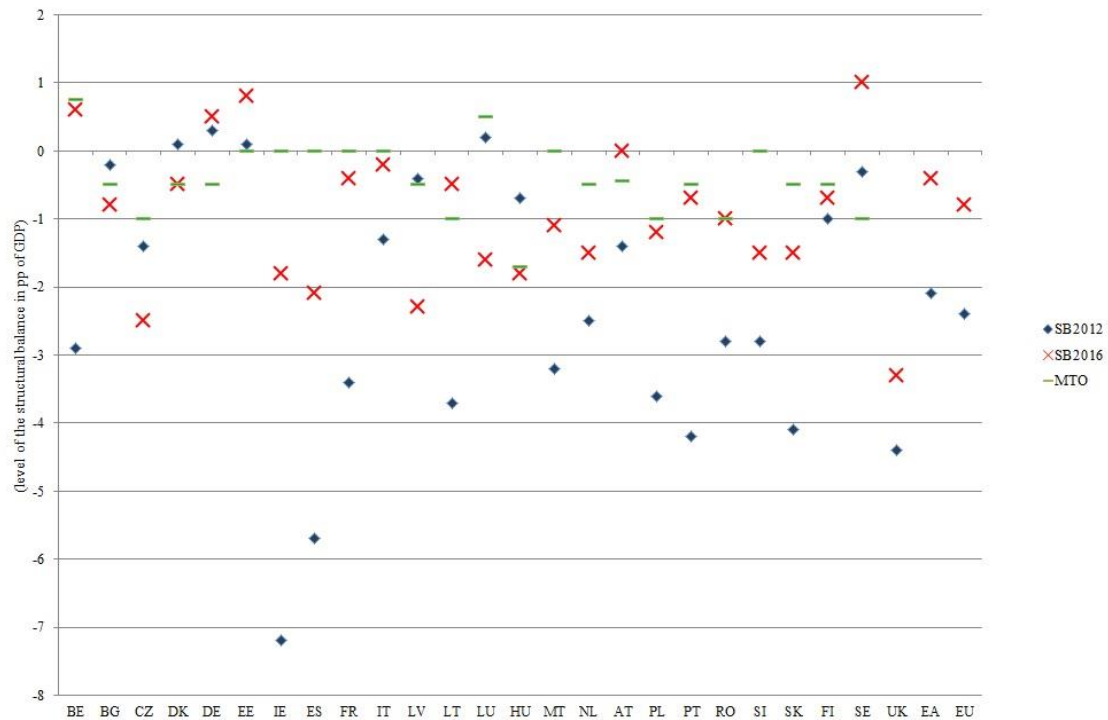
Following an update of the common parameters used to define MTOs, ⁽¹⁶⁾ the 2013 SCPs show a significant number of revisions of the objectives, although the EU and euro area averages remain broadly unchanged from last year. Graph I.2.3 presents Member States' structural balance at the start (2012, red cross) and at the end of the programme period (2016, blue diamond), together with their MTOs (green lines).

The graph shows a very mixed picture in terms of adjustment towards the MTO, with the possibility to distinguish four groups, on the basis of the structural balance as computed using the commonly agreed methodology. ⁽¹⁷⁾ On the one

⁽¹⁶⁾ The 2012 Update of the Minimum Medium Term Objectives, *Note for the Alternates of the Economic and Financial Committee*, agreed on 26 October 2012.

⁽¹⁷⁾ The recalculation of structural balances according to the common methodology might have an effect on the exact year of the MTO achievement as assessed in this note, when compared to the planned date presented in the programme.

Graph I.2.3: Planned changes in the structural balance between 2012 and 2016 and MTOs



This graph presents the structural balances of Member States in 2012 (red cross) and 2016 (blue diamond) as presented in their SCP and recalculated according to the commonly agreed methodology, versus their MTO (green line) as announced in their 2013 SCP. Some differences between the Commission's forecast and SCPs for 2012 structural balances may appear, due to possible different accounting of one-offs - this is particularly significant for Malta. The United Kingdom is not providing any MTO in its Convergence Programme; the MTO set by Slovenia does not reflect the requirements of the SGP

Source: Commission services

hand, Germany, Denmark, Estonia, Hungary, and Sweden have already achieved their MTO in 2012 (blue diamond is above the green line) and should maintain it through the programme, while Belgium, Italy, Lithuania, Austria, Poland, Portugal, Romania and Finland should gradually be reaching it by the end of 2016 (the red cross is above the green line). On the other hand, Bulgaria,

Luxembourg and Latvia are today planning to deviate from their MTO after having reached it in the course of the programme – generally reflecting country-specific events affecting the future structural balance, such as pension reforms or external shocks to revenues. Finally, Czech Republic, Spain, France, Ireland, Malta, the Netherlands, Slovenia and Slovakia do not foresee to achieve the MTO under the programme horizon, either because the distance from the objective is large or because they do not plan the annual

improvements which are expected under the SGP. ⁽¹⁸⁾

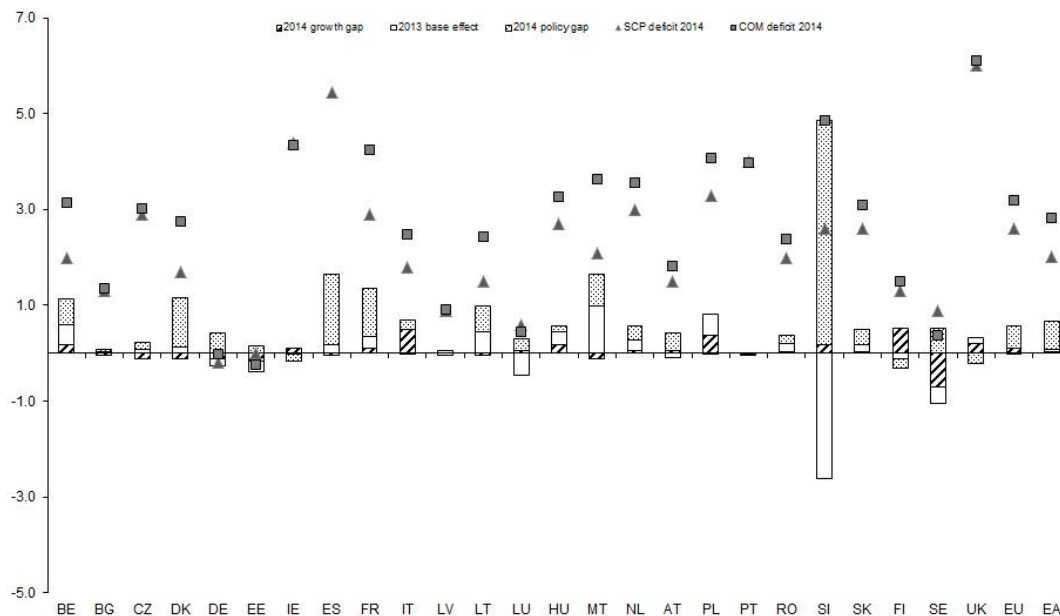
2.2.2.3 Risks to the SCPs targets: an assessment

The budgetary projections outlined in SCPs can be seen as vulnerable to three risks: i) less favourable macroeconomic conditions may negatively affect the achievement of the projections throughout the programme period; ii) the impact of the consolidation measures may have been overestimated; and iii) the projections may not be supported by sufficiently detailed measures, especially for the years not covered by the current budget.

Graph I.2.4 seeks to highlight these different risks by focusing on the gap between Member States' targets and the Commission services' deficit

⁽¹⁸⁾ Mind that Greece and Cyprus have not submitted the programmes and the MTOs this year and the United-Kingdom does not have an MTO.

Graph I.2.4: General government deficit for 2014: decomposition of the gap between SCPs plans and the Spring Commission forecast for EU Member States



The graph shows the level and component changes in Member States' deficit in 2014, as a percentage of GDP. The squares represent the deficit ratio from the Commission 2013 Spring forecast; the triangle the deficit planned in the SCPs. The point estimates show the actual values of the deficit, with the stacked lines representing the component. For the components, values above zero represent that the component has a deficit reducing effect in the SCP relative to the Commission 2013 Spring forecast, while values below zero indicate that the component increases the SCP deficit relative to the Commission's.

Source: Commission services

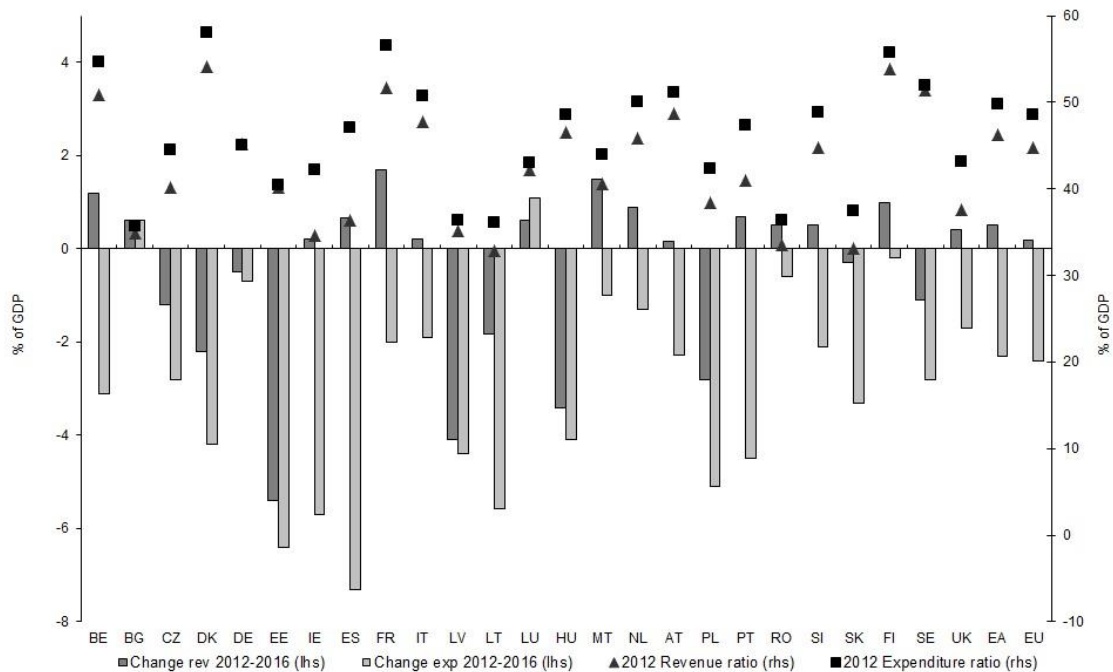
forecasts for 2014, in terms of the following three components: i) the difference in the deficits projected for 2013 (labelled the '2013 base effect'), reflecting differences in the growth projections for 2013 and/or the assessment of the impact of the measures in the 2013 budget; ii) the effect of difference in the growth projections for 2014 (labelled '2014 growth gap'), calculated using the standard semi-elasticities of budgetary balance to growth; and iii) the residual difference, (labelled the '2014 policy gap'), presumably mainly stemming from the absence of detailed consolidation measures for 2014 (and hence their non-inclusion in the Commission services' forecasts based on the no-policy change assumption).

There are significant differences between the Commission's and the SCP's projections for the deficit in 2014, both in aggregate and at individual country level, with the main driver being the policy gap. At EU level, the SCPs plans lead to an overall deficit of 2.6% of GDP, some 0.6% of

GDP lower than the Commission figure, with most of the difference corresponding to the policy gap. At euro area level, the difference between the SCPs and Commission deficits shows a similar pattern as the SCPs show a deficit figure of 2.0%, which is 0.8% of GDP lower than the corresponding Commission figure of 2.8%, with most of the difference corresponding to the policy gap.

The policy gap can in turn be attributed to a number of differences. It can be due to Member States' intentions to introduce new policy measures or to restrain expenditure – if these measures were not adopted or the plans not sufficiently specified at the time of the Commission 2013 Spring forecast they would result in a policy gap. For example, Belgium, Spain, France, Slovakia and Hungary project significantly lower total expenditure ratios in their SCPs than in the Commission forecast for broadly similar growth assumptions.

Graph I.2.5: Projected change in expenditure and revenue ratio (2012-2016, %GDP)



The graph represents the planned changes in revenue and expenditure ratios (lhs) between 2012 and 2016 against the starting GDP ratios of expenditure and revenue ratios (rhs) as notified.

Source: Commission services

However, the interpretation of the policy gap can also be comparable to the growth gap, in that it can represent a difference in assumptions. For example, countries can be projecting revenues based on different elasticities than in the Commission forecast meaning that they expect to get higher (or lower) revenues with no additional policy measures. Similarly, different assumptions about factors outside the government's control, in particular as interest payments can also have an effect.

As Graph III.2.4 shows, the policy gap is largest for Denmark, Spain, and France,⁽¹⁹⁾ with Belgium, Germany, Lithuania, Malta, Slovakia and Sweden also having gaps around the EU average. The underlying figures show that the countries with the highest policy gaps (Denmark, Spain and France) also project higher revenues on an unchanged policy basis than the Commission, indicating that the SCPs are based on more

ambitious assumptions about revenues rather than on the adoption of additional measures.

2.2.2.4 Composition of consolidation

Since the beginning of the current consolidation strategy, the EU has emphasised the need for a differentiated and growth-friendly consolidation across Member States. This includes an appropriate composition of consolidation in terms of both the overall expenditure-revenue mix (e.g. for Member States with high shares of public expenditure and revenues, a fiscal consolidation based on expenditure cuts rather than tax increases is considered more supportive to growth in the long-run) and the selection of types of spending and taxes that are more supportive to growth and social fairness.⁽²⁰⁾

On average, from 2013 to 2016 the consolidations set out in the SCPs are almost entirely expenditure-based for the EU and primarily expenditure-based

⁽¹⁹⁾ The case of Slovenia is not considered in this context as the figures are driven by the aid to the financial sector that increased the 2013 deficit.

⁽²⁰⁾ See the Annual Growth Survey 2013, available online at http://ec.europa.eu/europe2020/making-it-happen/annual-growth-surveys/index_en.htm

for the euro area.

Graph III.2.5 presents the 2012 starting level for revenue and expenditure (as percentages of GDP) as well as the change for the two variables by 2016, as set out in the SCPs. It shows that, on average, general government expenditure is projected to decrease by around 2 ½ pp of GDP in both the EU and the euro area (from 48.5% in 2012 to 46.1% of GDP in 2016 and from 49.8% in 2012 to 47.5% in 2016, respectively). The changes in the revenue ratios are overall smaller, with a projected increase of 0.5pp in the euro area (from 46.2% of GDP in 2012 to 46.7% in 2016), and of 0.2pp in the EU (from 44.7% of GDP to 44.9%). The change in the expenditure ratio corresponds to almost the entire reduction in the deficit in the EU and to 4/5th of the overall reduction planned in the euro area.

The fact that at EU level the planned fiscal consolidation is largely expenditure-based, while having a relative larger and negative effects in the short term (given higher short-term multiplier for expenditures), should reduce adverse effects on medium-term growth (given the high starting level of expenditure and revenue ratios), especially if the more growth-friendly spending items are preserved. However, the same conclusion does not necessarily hold for individual Member States since (i) expenditure and revenue ratios vary substantially by Member State, (ii) across Member States planned changes in expenditures and revenues are only weakly correlated with starting expenditure and revenue ratios, respectively (i.e. Member States cutting expenditures and revenues are not necessarily those with, respectively, higher expenditure and revenue ratios).

Table I.2.4: Fiscal adjustment for the EU: 2013 SCPs vs. Commission 2013 Spring forecast

	2013		2014		2015		2016	
	SCP planned Δ	EC forecast Δ	SCP planned Δ	EC forecast Δ	SCP planned Δ	EC forecast Δ	SCP planned Δ	EC forecast Δ
Revenues	0.4	0.7	0.0	-0.4	-0.2	-0.2	0.0	0.0
Expenditure	0.0	-0.2	-0.8	-0.5	-0.8	-0.8	-0.8	-0.8
Government balance	0.4	0.4	0.8	0.2	0.6	0.6	0.8	0.8

Source: Commission services

Table I.2.4 displays the annual changes in the deficit, expenditure and revenue ratios at the aggregate EU level as projected in the SCPs between 2013 and 2016. They are compared with

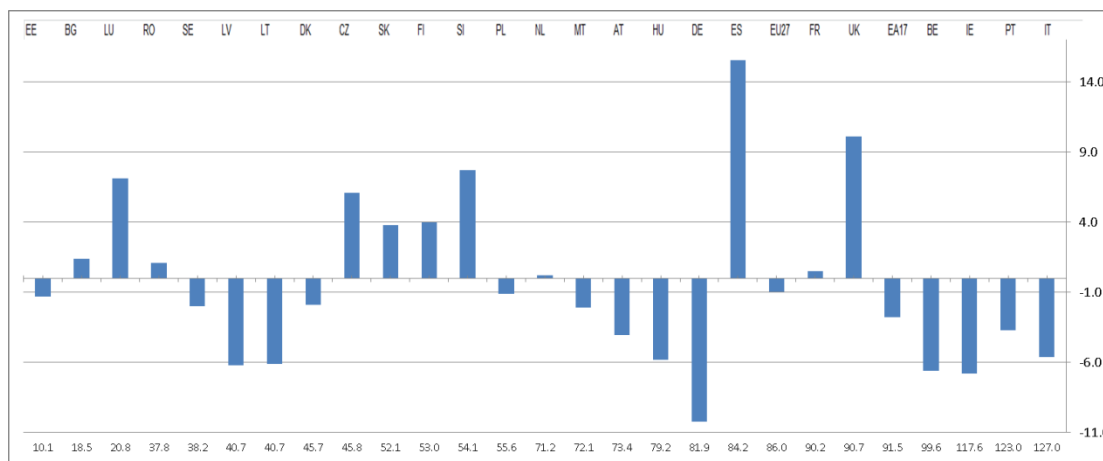
the corresponding changes according to the Commission 2013 Spring forecast for the years 2013 and 2014. The improvement in the headline balance according to Commission forecast marginally exceeds that projected by SCPs for 2013, whereas for 2014 the improvement in the primary balance is much larger according to SCPs than in Commission 2013 Spring forecast. This is unsurprising since 2014 figures in Commission forecast are based on a no-policy change scenario, i.e. do not include policy actions that are not certain.

Table I.2.4 also shows the composition of the planned adjustment (expenditures vs. revenues). For 2013, the SCP adjustment is fully revenue-based, while the Commission forecast envisages a consolidation based for around 4/5th on revenues. Conversely, for 2014, 2015 and 2016, SCP consolidation is entirely expenditure-based, with revenues even decreasing (as a share of GDP) in 2015 and 2016. Overall, the envisaged adjustment appears to be front-loaded on the revenue side (albeit a small share of the overall adjustment) and slightly back-loaded on the expenditure side, raising the need to closely monitor the implementation of planned expenditure cuts by Member States over the programme horizon.

The Stability and Convergence Programmes also provide information on the envisaged composition of fiscal consolidation by main type of government expenditure. At aggregate EU level these show two main developments; (i) a generalised reduction of public investment, running against the Commission and Council recommendations to preserve this type of spending amid consolidations; ⁽²¹⁾ and (ii) a generalised reduction in compensation of employees and intermediate consumption, which is often considered by the literature as growth-friendly over the medium term. Therefore, even based on broad spending categories, no firm general conclusion can be drawn on whether the spending composition in the

⁽²¹⁾ The blueprint for a deep and genuine economic and monetary union and the two-pack (See Part II) require the Commission to explore ways within the preventive arm to accommodate investments in the assessment of the SCPs. The Commission provided indications on how it intends to act in a letter by VP Rehn of 3 July (http://ec.europa.eu/commission_2010-2014/rehn/documents/letter_on_investment_clause_en.pdf; see also press release <http://europa.eu/rapid/midday-express-03-07-2013.htm>)

Graph I.2.6: Changes in general government debt projected in SCPs 2012-2016



Member States are ordered according to increasing debt level (horizontal axis). The bars indicate the change in debt-to-GDP ratio over the period. The graph shows no correlation between the size of debt reduction and the initial debt level.

Source: Commission services

EU is to become more growth-friendly or less based on current SCP plans.

2.2.2.5 Debt implications

According to the plans presented in the SCPs, general government debt in the EU is expected to peak at slightly above 90% of GDP in 2013-2014 and fall back to 86% in 2016. Similarly in the euro area, overall debt is projected to reach around 94% of GDP in 2013-2014 before decreasing to slightly below 90% in 2016.

The trend of falling debt ratios as from 2014 would be the result of the fiscal consolidation that has taken place so far in the EU, and the average debt-to-GDP ratio in the EU in 2016 is expected to be almost 2.5pp below the level in 2012. Graph I.2.6 shows the starting debt level in 2012 and the increases pencilled in between 2012 and 2016.

For all Member States with a debt above the 60% of GDP, debt is projected to be lower in 2016 than in 2012 except in the United Kingdom and in Spain which project a large increase, and in the Netherlands and France but by a very small margin. ⁽²²⁾

⁽²²⁾ Based on plans, up to 2016, Member State concerned by the transition period of the debt criterion would overall implement structural adjustments large enough to meet the debt benchmark by the end of their transition period. A

While consolidation is a prerequisite for the debt ratio to decrease in the long run, the debt dynamics also depends significantly on the interest rate-growth differential (i.e. the “snow-ball” effect) and on stock-flow adjustments. ⁽²³⁾ Graph I.2.7 shows the contribution of fiscal consolidation (change in primary balance), of the difference between GDP growth and interest rates, and of the stock-flow adjustment to the change in the debt-to-GDP ratio between 2012 and 2016.

The debt ratio is projected to fall on average between 2012 and 2016 as a result of improvements in the primary balance. The contribution of consolidation is expected to more than offset the debt-increasing effect of the snow-ball effect. The stock-flow adjustment is expected on average to play a minor role on the debt dynamic up to 2016.

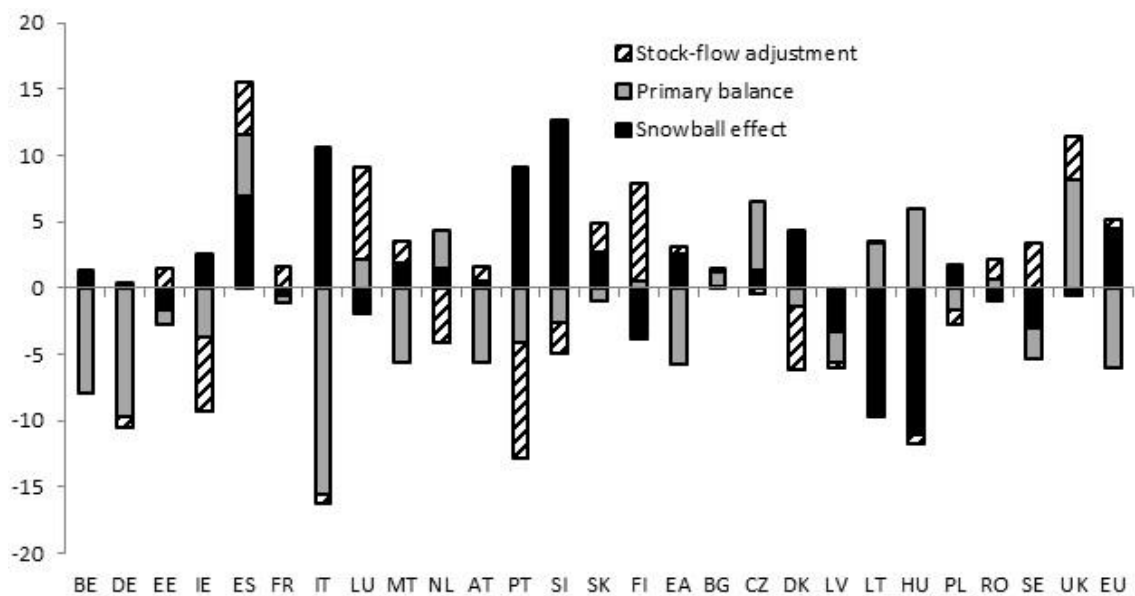
detailed country-specific analysis is provided in the Staff Working Documents accompanying the CSRs.

⁽²³⁾ The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * (r_t - g_t) \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; D , PD , Y and SF are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and r and g represent the average real interest rate and real rate of GDP growth. The term in parentheses represents the “snow-ball” effect, measuring the combined effect of interest expenditure and economic growth on the debt ratio.

Graph I.2.7: Contributions to the change in the debt-to GDP ratio between 2012 and 2016



Source: Commission services

The development of stock-flow adjustments is very much differentiated by Member State, and depends on country-specific situations. If in the EU stock-flows are slightly contributing to increase debt, few Member States project large debt-reducing stock-flow operations. The underlying reasons are country-specific, and can be related to necessity of supporting the financial sector and the payment of arrears of suppliers like in Spain (in 2013) or to the accumulation of assets in the pension system like in Finland.

The debt-decreasing impact of primary balances is projected to be particularly large (over 10pp) in Germany and Italy. On the opposite side, the primary balance is adding up to debt ratios over the whole period by more than 5pp in Spain, Czech Republic, Hungary and the United Kingdom

2.2.2.6 Short, medium and long-term fiscal sustainability

Given debt projections, it is relevant to assess the sustainability of public finances in the Member

States, against the background of the impact of the crisis and the demographic evolution.⁽²⁴⁾

The enhancement of the fiscal sustainability assessment framework in the Fiscal Sustainability Report 2012⁽²⁵⁾ supplements the traditional focus on long-term fiscal risks with medium- and short-term risk indicators. This multidimensional approach makes it possible to assess:⁽²⁶⁾

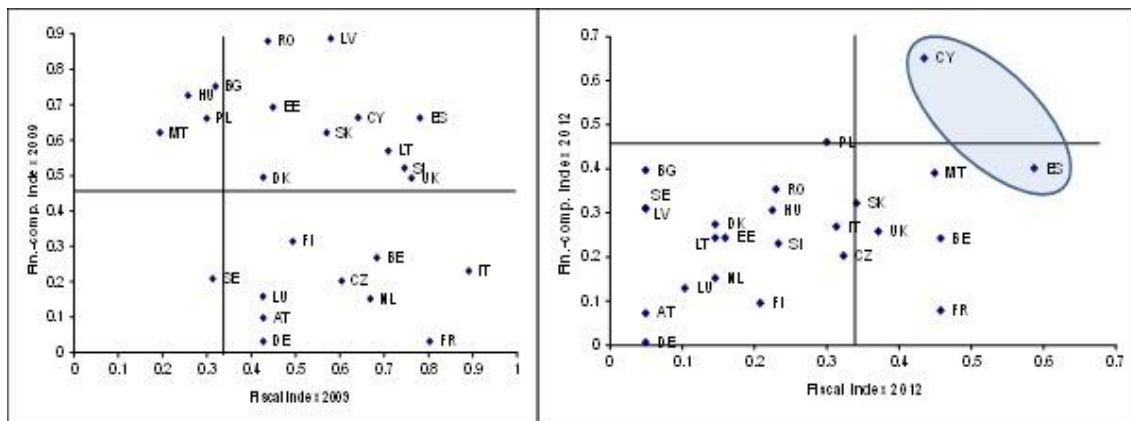
- short-term challenges, based on the S0 indicator ('early detection of fiscal stress');

⁽²⁴⁾ Ageing projections come from the 2012 Ageing Report. European Commission (DG ECFIN) and Economic Policy Committee (AWG) (2012).

⁽²⁵⁾ European Commission (2012c),.

⁽²⁶⁾ The S1 and S2 indicators are traditional sustainability indicators based on forecasts for growth and fiscal balances, extrapolated by incorporating the long-term projections of the 2012 Ageing Report, in particular the projected trend in age-related expenditure. The higher the values of the S1 and S2 sustainability indicators, the greater the required fiscal adjustment and thus the sustainability risk. The S0 indicator is a new indicator based on current data, aggregating fiscal and macro-financial variables which have proven to be good predictors of fiscal stress episodes. The methodology for the S0 indicator is fundamentally different from the S1 and S2 indicators mentioned above. It is not a quantification of the required fiscal adjustment as in the case of the S1 and S2 indicators, but a composite indicator which estimates the extent to which there might be a risk of fiscal stress in the short term.

Graph I.2.8: The S0 indicator, 2009 and 2012



Source: Commission services.

- medium-term challenges, based on the modified S1 indicator (‘debt compliance risk’);
- long-term challenges, based on the S2 indicator (‘ageing-induced fiscal risks’).
- the "COM no-policy-change" scenario, with structural primary balance/GDP ratio kept constant at 2014 estimated level as in Commission 2013 Spring forecast (reflecting a "no-policy-change" assumption);⁽²⁷⁾

Short-term challenges: the S0 indicator - early detection of fiscal stress

In terms of short-term challenges, risks for fiscal stress have been reduced in nearly all Member States in the last years. While in 2009 almost two thirds of the EU Member States were above the critical threshold for the S0 indicator, indicating at that time elevated risks of fiscal stress for 2010, in following years short-term risks have been progressively reduced (see Graph I.2.8).

In 2012, according to the S0 indicator highlighting fiscal risks for 2013, only two Member States appear to be still at risk, Spain and Cyprus (see also Table I.2.5). However, full implementation of the planned fiscal adjustment in Spain would go a long way towards reducing the risk for fiscal stress in the short term.

Medium- to long-term challenges

In terms of medium and longer term implications for fiscal sustainability taking account of the projected changes in age-related expenditure, the macroeconomic scenario and the fiscal outlook and plans, two main scenarios are considered:

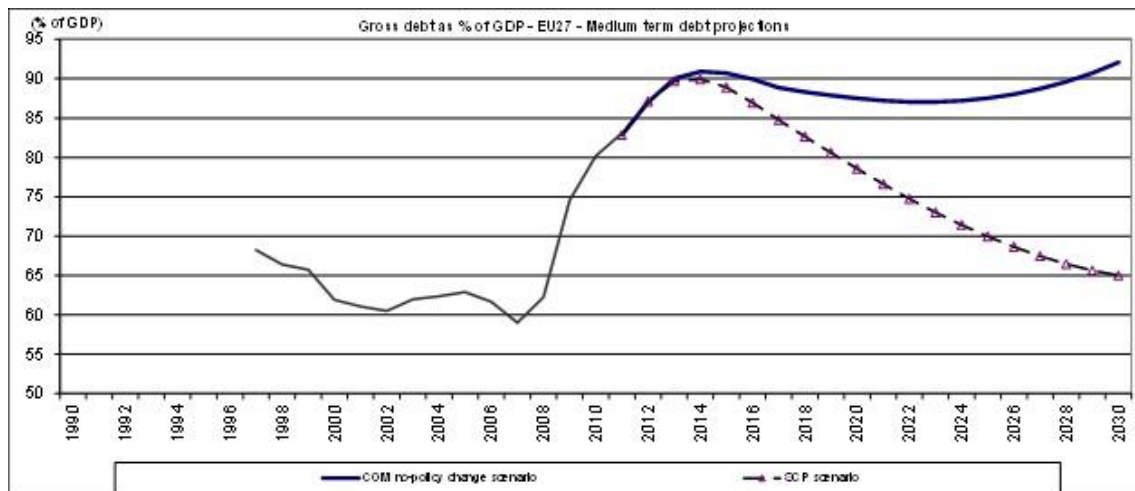
- the "SCP" scenario (structural primary as balance/GDP ratio kept constant at end of programme period covered by the SCPs), reflecting planned changes in fiscal policies reported in the SCPs.

Graph I.2.9 depicts the projected evolution for the government gross debt ratio (including the projected change in age-related expenditure), for the EU as a whole, assuming with the dotted line that the plans set out in Member States' SCPs are fully implemented. The counterfactual scenario is given by the solid thick line, which shows the outcome if no fiscal consolidation measures were introduced beyond those contained in the Commission 2013 Spring forecast (structural primary balance/GDP ratio kept constant at 2014 estimated level). Those scenarios incorporate expected future age-related spending, as projected in the 2012 Ageing Report.

The impact of pension reforms undertaken since the completion of the 2012 Ageing Report in

⁽²⁷⁾ It should be noted that the meaning of the expression “no-policy change” in this context – indicating constant structural balance after 2014 – is different from the meaning of the same expression in the context of forecast, where it indicates the forecast that takes into account only the fiscal measures legislated which was used in the previous sections.

Graph I.2.9: Medium term debt projections for the EU



Note: The medium-term projections are based on the Commission services' spring 2013 forecast (up to 2014), and the macro-economic scenario of the 2012 Ageing Report. As a general rule, the output gap is assumed to close in t+5, after which the potential growth rates converge linearly to the AWG baseline scenario by t+10. The inflation rate (GDP deflator) converges linearly to 2% in 2017, when the output gap is closed and remains constant thereafter, for all countries. The overall (real) implicit interest rate on maturing debt (new and rolled-over) converges to 3% by 2017. The structural primary balance is kept unchanged after 2014 apart from the projected change in age-related expenditure according to the AWG reference scenario from the 2012 Ageing Report. The primary balance is adjusted by using the budget sensitivities in the period until the output gap is assumed to be closed (by 2017 as a rule). No stock-flow adjustment assumed after 2014 (end of forecast horizon).

Source: Commission services.

Belgium, Denmark, Hungary and the Netherlands were incorporated in the Commission's Fiscal Sustainability Report 2012 released on 18 December 2012. In addition, the impact of pension reforms in Poland, Latvia, the Czech Republic, Bulgaria and Slovakia are included in the analysis in this section. According to the Commission 2013 Spring forecast, debt rises to 90.9% of GDP in 2014 in the EU as a whole. Given the significant fiscal consolidation until 2014, debt is projected to decrease in the following years.

Moreover, the cost of ageing as a share of GDP is almost stabilized in the years to the mid-2020s. However, from 2024 onwards, the ageing costs take hold more firmly, and debt starts rising. As a result, debt in the EU as a whole reaches 92% of GDP in 2030, though with large differences across Member States.

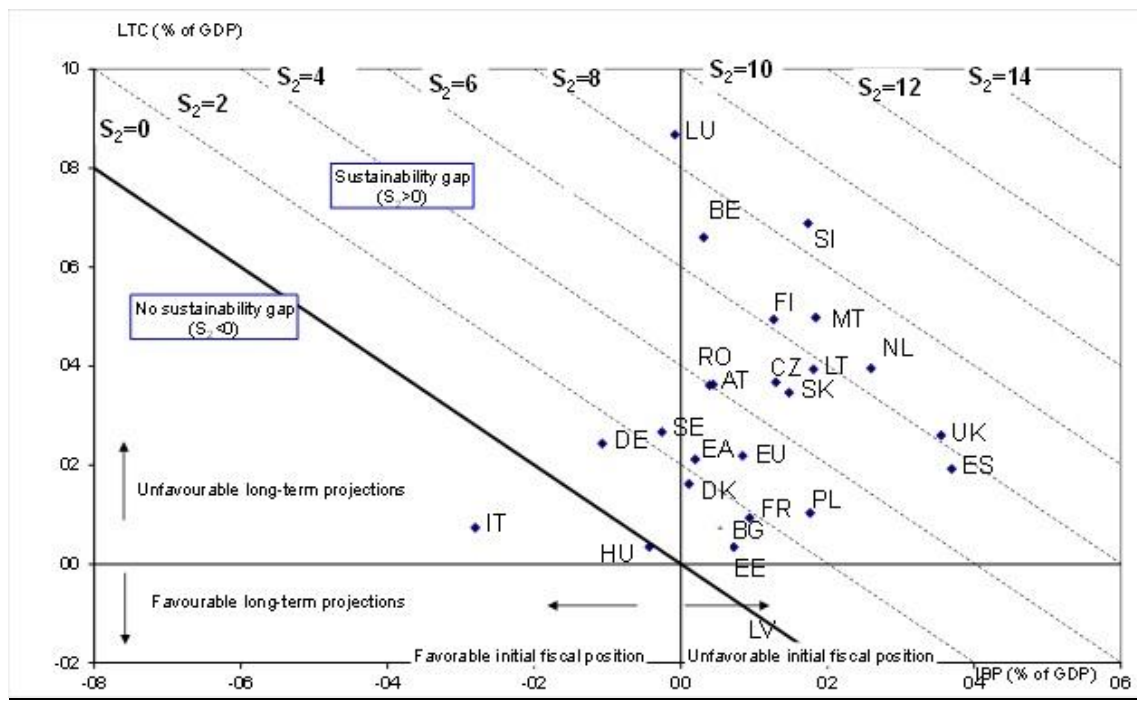
In contrast to the "COM no-policy-change" ⁽²⁸⁾ scenario, the "SCP" scenario would lead to a more marked reduction in the debt-to-GDP ratio. However, debt would still be above the Treaty reference value of 60% of GDP by 2030 (at 65% of GDP).

Another way of looking at the adjustment needed in the medium-to-long term with respect to unchanged policies is to calculate the additional fiscal adjustment required up to 2020 in order to stabilize the debt-to-GDP ratio at 60% by 2030 (see Graph I.2.10). The improvement required in the structural primary balance to achieve a debt-to-GDP ratio target of 60% by 2030 amounts to 2.2 percentage points of GDP over the period 2015–2020 in the EU as a whole, i.e., an average annual fiscal consolidation effort of 1/3 percentage points per year. In other words, the structural primary balance in the EU has to improve from a forecasted surplus of 1.5% of GDP in 2014 (structural balance of -2.1% in 2014) to a surplus of 3.7% in 2020.

However, the required consolidation effort varies significantly across Member States, depending on the initial structural primary balances, starting debt ratios, future ageing costs and the growth prospects over the next 20 years. It should be noted that for some Member States, the structural primary balance in 2014 – the starting point for the medium-term projections – is very high, compared with what has been achieved in the past.

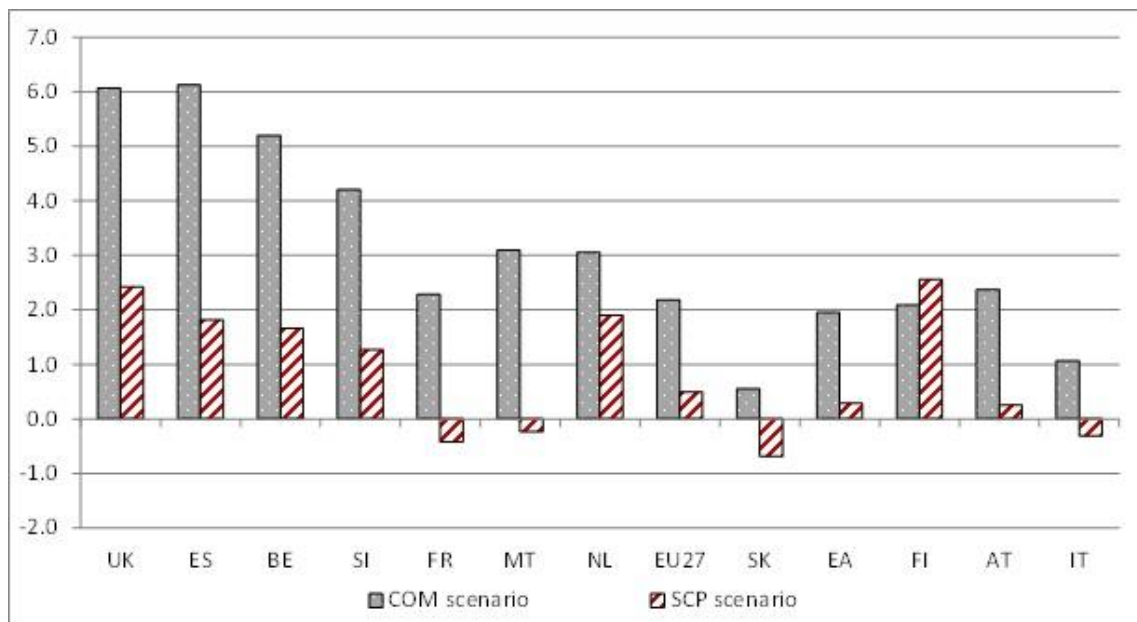
⁽²⁸⁾ See previous footnote.

Graph I.2.10: The S2 sustainability gap decomposed



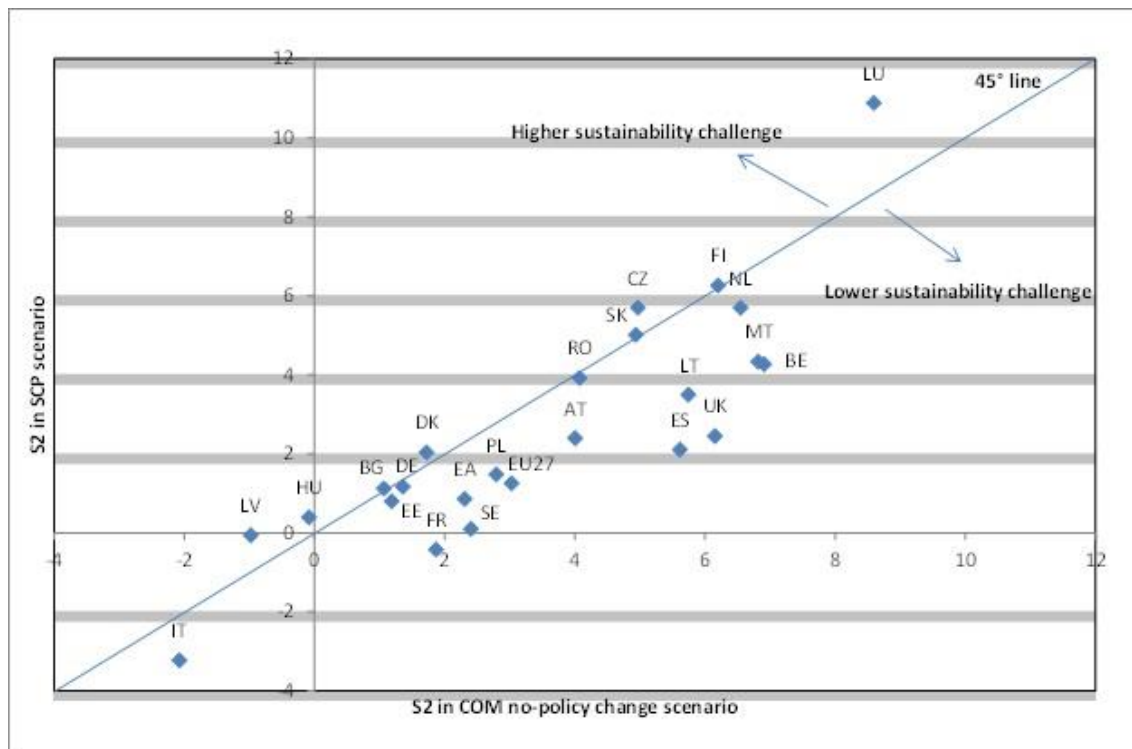
Source: Commission services.

Graph I.2.11: S1 indicator (fiscal adjustment required until 2020 to reach a 60% public debt/GDP ratio by 2030, in per cent of GDP)



Source: Commission services.

Graph I.2.12: The S2 sustainability gap: 'COM no-policy-change' and 'SCP' scenarios



Source: Commission services. 2013 Stability and Convergence Programmes

Thanks to substantial consolidation efforts, the structural primary balance in 2014 is estimated to end 2 pp of GDP higher than observed on average over the period 1998-2012 in the Czech Republic, Romania and Slovakia, and more than 3 pp of GDP higher in Greece, Italy, Hungary, Portugal. The adjustment of the primary balance required to reach a 60% of GDP debt ratio under the assumption of the COM no-policy-change scenario would be particularly demanding, indicating high risk (a fiscal consolidation effort over the period 2014-2020 higher than 3 pp of GDP) in Belgium, Spain, Malta, Netherlands, Slovenia, and the United Kingdom. Fiscal sustainability risks would be medium for Czech Republic, France, Italy, Lithuania, Austria, Poland, Slovakia, and Finland. The others are at low risk.

If the fiscal plans in the SCPs are fully implemented and additionally not weakened after the end of the programme horizon, additional fiscal consolidation, beyond the end of the period covered by the programmes (generally 2016) would be needed in Belgium, Czech Republic, Spain, Luxemburg, Netherlands, Austria, Slovakia,

Finland and the United Kingdom, to reach 60% of GDP in 2030.

The S2 indicator –ageing-induced fiscal risks

In the long term, the sustainability of the fiscal position is assessed by the gap relative to the primary balance required to stabilize debt at the current level and pre-finance all the future increases in age-related expenditures. Graph I.2.11 shows the S2 sustainability indicator according to the 'COM no-policy-change' scenario.

It shows the initial fiscal position (IBP) on the horizontal axis and the long-term change in the fiscal position on the vertical axis. A dot positioned to the left has a favourable IBP; if it is below zero, it means that the budgetary position contributes positively to fiscal sustainability. A dot positioned towards the bottom of the axis has a low long-term 'cost of ageing'. The horizontal lines indicate the size of the sustainability gap. For example, the EU a whole has a sustainability gap of 3pp of GDP. The structural primary balance in 2014 – the starting point for the medium-term

projections – is very high compared with what has been achieved in the past in some Member States and maintaining such primary balances over the medium term and beyond, as assumed in the no-policy-change scenario, may prove challenging in view of competing fiscal pressures.

Graph I.2.12 shows the S2 indicator calculated on the basis of the projected changes in age-related expenditure up to 2060 (from the 2012 Ageing Report and incorporating pension reforms after its

(i) the "COM no-policy-change" scenario (see above) and

(ii) the "SCP" scenario. According to the COM no-policy-change scenario, fifteen Member States have a sustainability gap of 2% of GDP or more indicating medium risk⁽²⁹⁾ and seven of these have a gap higher than 6% of GDP (Belgium, Luxembourg, Malta, Netherlands, Slovenia, Finland and the United Kingdom) indicating high risk.

The 'SCP' scenario shows the extent to which the implementation of the fiscal consolidation plans would contribute to ensuring fiscal sustainability because it is constructed assuming that Member States respect their projections. Under the assumption that the fiscal plans in the programmes are fully implemented, nearly all Member States are expected to have a lower sustainability gap (as shown a position below the 45° degrees line in the figure). In the EU as a whole, the S2 fiscal gap would be 1.2% of GDP. Even assuming the full implementation of the fiscal plans in the SCPs, thirteen Member States would still have sustainability gaps in excess of 2 % of GDP (Belgium, Czech Republic, Denmark, Spain, Lithuania, Luxembourg, Malta, Netherlands, Austria, Romania, Slovakia, Finland, and the United Kingdom) and two Member States over 6 % of GDP (Luxembourg and Finland). In terms of risk classification, in the 'SCP' scenario, six Member States would go to a lower risk category (Belgium, Malta, the Netherlands and the United Kingdom from 'high' to 'medium' risk, Poland and Sweden from 'medium' to 'low' risk), and one Member State would go to a higher risk category (Denmark from 'low' to 'medium' risk). On the basis of the multidimensional approach and the indicators described in this section, a summary of the fiscal sustainability analysis is provided in Table I.2.5.

Table I.2.5: Risk classification in the 2013 assessment round, COM 'no-policy-change' scenario

	S0 Short-term fiscal sustainability challenge	S1 Medium-term fiscal sustainability challenge	S2 Long-term fiscal sustainability challenge
BE	Low (0.3)	High (5.2)	High (6.9)
BG	Low (0.3)	Low (-2.9)	Low (1.1)
CZ	Low (0.24)	Medium (0.7)	Medium (5)
DK	Low (0.24)	Low (-2.5)	Low (1.7)
DE	Low (0.02)	Low (-0.3)	Low (1.4)
EE	Low (0.22)	Low (-3.4)	Low (1.2)
ES	High (0.45)	High (6.1)	Medium (5.6)
FR	Low (0.19)	Medium (2.3)	Low (1.9)
IT	Low (0.28)	Medium (1.1)	Low (-2.1)
LV	Low (0.24)	Low (-3)	Low (-1)
LT	Low (0.22)	Medium (1)	Medium (5.7)
LU	Low (0.12)	Low (-1.5)	High (8.6)
HU	Low (0.28)	Low (-1.4)	Low (-0.1)
MT	Low (0.41)	High (3.1)	High (6.8)
NL	Low (0.15)	High (3.1)	High (6.5)
AT	Low (0.07)	Medium (2.4)	Medium (4)
PL	Low (0.41)	Medium (1.1)	Medium (2.8)
RO	Low (0.32)	Low (-0.8)	Medium (4.1)
SI	Low (0.23)	High (4.2)	High (8.6)
SK	Low (0.33)	Medium (0.6)	Medium (4.9)
FI	Low (0.13)	Medium (2.1)	High (6.2)
SE	Low (0.24)	Low (-2.7)	Medium (2.4)
UK	Low (0.29)	High (6.1)	High (6.2)
EU27	:	Medium (2.2)	Medium (3)
EA	:	Medium (2)	Medium (2.3)

Note: S0 indicator: Member States with a value for the overall composite indicator above the threshold (0.44) in 2012 are at risk for fiscal stress in the year ahead.

The S1 indicator: The following thresholds were used to assess the scale of risk for 'debt compliance':

- if the S1 value is less than zero, the Member State is assigned low risk;
- if it is between 0 and 3 (thus requiring a structural adjustment in the primary balance of up to 0.5 pp of GDP per year – the benchmark adjustment in the SGP - until 2020), it is assigned medium risk; and,
- if it is greater than 3 (meaning a structural adjustment of more than 0.5 pp of GDP per year is necessary), it is assigned high risk.

The S2 indicator: As was the case in the 2009 Sustainability Report, the following thresholds for the S2 indicator were retained:

- if the value of S2 is lower than 2, the Member State is assigned low risk;
- if it is between 2 and 6, it is assigned medium risk; and,
- if it is greater than 6, it is assigned high risk

Source: Commission services

release) with two different starting points:

⁽²⁹⁾ Belgium, Czech Republic, Spain, Lithuania, Luxembourg, Malta, Netherlands, Austria, Poland, Romania, Slovenia, Slovakia, Finland, Sweden and the United Kingdom

(hereinafter referred to as the Directive).⁽³⁰⁾ The improvement in national fiscal frameworks is one of the objectives of the strengthening of the EU fiscal governance, which aims at combining the need for appropriate national fiscal policy with greater national ownership of the European framework.

Moving beyond EU budgetary surveillance according to rules, processes and thresholds defined at EU level, and consistently with it, the Directive provides the first opportunity for Member States to enshrine in their own national legal order and budgetary processes a set of essential requirements supporting common objectives across Member States. All Member States have to transpose the Directive by 31 December 2013 by determining the most appropriate means to comply according to their national context and preferences. As the text entered into force end-2011, they have been given two full years to determine and set into law the necessary elements.

Upon the entry into force of the Directive, although some Member States were more advanced than others, thus leading to differentiated institutional efforts needed to comply with the Directive, no Member State had reached such a stage where no additional measures would be necessary to bring its budgetary framework up to the standards set by the Directive. Beyond the introduction and enhancement of institutional features, the successful enforcement of such reforms is paramount.

In order to take stock of the progress in strengthening national fiscal frameworks by transposing the Directive, the Commission prepared an interim progress report.⁽³¹⁾ This informative report was made public and submitted to the Council and the European Parliament in

mid-December 2012, as required by Article 15(3) of the Directive. It consisted in a Communication providing an overview of the progress made in transposing to date – mirroring the structure in five policy sections of the Directive, and in an accompanying Staff Working Document including one fiche per Member State. This interim progress report was primarily based on information provided by the Member States which transmitted information on their progress and plans in autumn 2012. It is important to stress that the report provides only a snapshot of the national efforts to comply with the Directive; in accordance with the existing practice, the Commission will conduct a full-fledged assessment only after the transposition deadline.

The main insights from this interim progress report are summarised hereunder. These insights are further illustrated by a focus on five Member States (Austria, Bulgaria, France, Slovakia and Spain) who have taken some significant steps to enhance their national budgetary frameworks since 2011.

Overall, Member States reported substantial but uneven progress in transposing the Directive. Regarding the accounting and statistical provisions, Member States have still some way to go to ensure timely and comprehensive coverage for all general government sub-sectors. In parallel with the Member States' efforts, Eurostat established, together with national experts, a Task Force on the implications of the Directive on the collection and dissemination of fiscal data, which prepared a set of methodological guidelines on this specific issue. As to the forecasts provisions, reported elements lack detail in quite a few Member States. Progress is somewhat more advanced regarding numerical fiscal rules requirements: a wide array of national instruments is being prepared to buttress national fiscal policy-making.

The mutually-reinforcing nature of all pieces of legislation contained in the Six Pack, combined with the additional impetus brought by the TSCG and by the agreement on the Two Pack, has helped placing these issues high on the Member States' reform agenda. While many Member States reported that Medium-Term Budgetary Frameworks in the sense of the Directive were in place or planned, the details given are sometimes

⁽³⁰⁾ Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, published on 23 November 2011 in the Official Journal of the EU. The Directive is one of the components of the legislative package on the strengthening of economic governance (also known as the 'Six Pack') reforming the SGP

⁽³¹⁾ Interim Progress Report on the implementation of Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States, European Commission, European Economy - Occasional Paper 128, February 2013.

scarce and do not provide yet enough evidence of full compliance with the Directive's specifications. Finally, work on effective coordination arrangements for sub-national governments is being carried out in many Member States, but the positive intentions reported need to be turned into concrete and enforceable arrangements. A number of Member States considered good fiscal performers have reported fewer completed reforms at this stage, but are considering formalising part of their currently informal framework for increased efficiency.

Beyond these overall messages, there are also more specific considerations in the interim progress report, addressing in more detail the key issues covered by the Directive. A summary is presented below and a presentation of the reforms undertaken in a selection of Member States is given in Box I.2.1.

A) ACCOUNTING, STATISTICS AND TRANSPARENCY

Sound fiscal policy should be based on sound fiscal reporting. Comprehensive, timely and accurate information on budgetary execution is essential for policy-makers. Up until recently, high-frequency fiscal reporting has been patchy in the majority of Member States. Even where reporting duties were properly defined, general government data have been collected for different tiers of government under different accounting rules or statistical principles, in terms of frequency, reporting deadlines or compilation methodologies. Against this background, negative budgetary developments have remained undetected for an overly long period of time, especially when they originated in non-central government entities.

In response to this, the Directive (Chapter II and Article 14) provides a major opportunity to harmonise accounting conventions within general government, streamline reporting lines, and ensure an effective data feed to decision-makers and external observers. Enshrining existing informal collection processes and new statistical requirements in law would ensure that the hundreds — and sometimes thousands — of entities entering the general government definition are properly integrated within a comprehensive data collection system. In particular, the Directive sets standards for a comprehensive and consistent

nature of national public accounting systems across all subsectors, for the regular publication of fiscal data (monthly for central government, state government and social security; quarterly for local government) and for the publication of major contingent liabilities. The Directive also requires Eurostat to publish Member States' quarterly debt and deficit levels.

More efforts are required in many Member States to make fiscal data of non-central government sectors available timely. While almost all Member States make monthly data for the central government bodies available in cash or other accounting basis, fiscal data availability is lower for social security entities, and even scarcer for local government, and on-going reforms are not yet completed for state government in several federal states. For the implementation of Article 4(7) of the Directive, Eurostat released for the first time on 6 February 2012 a dedicated, regular press release on quarterly government debt, providing data for the EU, the euro area and individual Member States. A similar initiative is envisaged for the quarterly deficit.

B) MACROECONOMIC AND BUDGETARY FORECASTS

Macroeconomic and budgetary forecasts used for fiscal planning have long been considered a weak spot in the production of annual budgets. Some Member States have been seen for a long time to be suffering from a bias in their fiscal estimates. This is why the Directive pays particular attention to forecasting by devoting a chapter to this issue (Chapter III). It essentially requires Member States to base their fiscal planning on realistic and up-to-date macroeconomic and budgetary forecasts, to identify the body responsible for their production, to explain significant deviations from the Commission's forecasts, to publish their main assumptions and to undertake ex-post evaluation of their own forecasts in order to detect and correct potential bias. For euro area Member States, the Two Pack further specifies the involvement of independent bodies in producing or endorsing government's forecasts used for the preparation of the budget.

Overall, a third of Member States reported having structured processes in place, involving several institutions or bodies, to ensure transparency and

accountability of the forecasts. Other Member States are still at the drawing board stage, or have so far reported only declarations of intent. The drafting of alternative macroeconomic and budgetary scenarios — a sound preventive step that facilitates budget shifts at the budget execution stage when actual parameters depart from the central scenario — was reported by a third of Member States. Only a minority of Member States reports that they compare (or plan to compare) their forecasts with those of the Commission. Few Member States reported having taken in 2012 any specific measures to assess ex post the quality of forecasts in the sense of Article 4(6) of the Directive.

C) NATIONAL NUMERICAL FISCAL RULES

Well-designed rules-based frameworks are known to significantly enhance budgetary discipline. At the European level, the SGP already provides for a set of fiscal rules – concerning the nominal and structural deficit, as well as ensuring a rapid decrease of high debt levels. The Directive requires Member States to have in place country-specific numerical fiscal rules that effectively promote compliance with these Treaty obligations in the field of budgetary policy. While Chapter IV does not specify such rules in detail, it states that they must include requirements to ensure an appropriate definition of the targets and scope of the rules, an effective and timely independent monitoring, strict compliance mechanisms and well-circumscribed escape clauses. In particular, periodic checks by monitoring institutions with sufficient authority would also provide an opportunity to raise awareness of fiscal sustainability, and foster a healthy debate with fiscal authorities and the general public on shared national fiscal objectives.

Spurred by the introduction of the Directive and supported by the TSCG, major reforms leading to an overhaul of fiscal rules have been unveiled or are reportedly already completed in twenty Member States. Including proposed legislation and entry into force after a transitional period, new budget balance rules have been unveiled in fourteen Member State, while existing budget-balance rules are being strengthened in five other Member States. Expenditure rules are being established in ten Member States, and reformed in

five other Member States. The introduction or strengthening of national debt rules is a new development in twelve Member States. In addition, Member States under an adjustment programme are subject to a multi-annual, multi-target framework constraining their fiscal policy as a de facto fiscal rule with enhanced features for monitoring and enforcement. Many Member States declare that the new or updated rules will have features in line with the Directive's requirements. In particular, almost half of the Member States report that monitoring institutions are or will be tasked with assessing the implementation of national numerical fiscal rules. Overall, the establishment of national numerical fiscal rules appears to be on the right track. However, their specific features and overall consistency will have to be assessed against the requirements of the Directive's Articles 5 and 6.

D) MEDIUM-TERM BUDGETARY FRAMEWORKS

Under the Directive (Chapter V), Member States are required to establish a credible, effective Medium-Term Budgetary Framework (MTBF) – i.e. a set of rules and procedures to frame fiscal policy-making with a medium-term perspective – over at least three years, enabling them to expand fiscal planning beyond the annual horizon and thereby fostering more consistent, effective and potentially ambitious policy-making over the medium term. If annual budgets need to be adapted to specific contingencies of the macroeconomic outlook for instance, the stability of fiscal planning, ensured by a consistent vision over the medium-term, is proved essential for sounder public finances through the cycle. The institution of MTBFs in all Member States intends to help delivering and updating this medium-term vision.

An appropriately-designed MTBF contains multi-annual budgetary objectives, in combination with projections of each major revenue and expenditure item based on unchanged policies, with explanations of corrective medium-term policies to bridge the gap between the no-policy change projections and policy targets. Additionally, it features an assessment as to how the policies envisaged are likely to affect the long-term sustainability of public finances. Wherever necessary, the MTBF should replace existing planning documents or consolidate them into a

single, well-identified, strategic document. Consistency is critical and should be understood along several dimensions. First, the MTBF should genuinely serve as a basis for the subsequent preparation of the annual budget. Second, as some Member States have developed multiannual binding fiscal rules, figures derived from these fiscal rules should naturally feed into the MTBF. Third, the MTBF document(s) should also be consistent over time by documenting in detail and transparently numerical adjustments. Finally, the MTBF positioning in the national budgetary timeline should be defined taking into account the requirements stemming from the 'two-pack' regulations and from the European Semester process.

Multi-annual frameworks were reported to be in place or concrete plans exist to establish them, in twenty-two Member States. Almost all are of a rolling nature and consequently updated at least every year with the inclusion of an outer year. Ten reported multi-annual frameworks span three years, nine four years and two, five years. Multi-annual frameworks are also a vehicle of choice for setting expenditure ceilings or targets in almost half of the Member States, although the presentation of medium-term developments only for expenditure would not suffice to qualify as a medium-term budgetary framework in the sense of the Directive. Finally, only a few Member States report legislative provisions ensuring the consistency between annual and multiannual budgets, and even fewer report that multi-annual projections are presented under a no-policy change basis. The latter is crucial to establish a baseline scenario against which the impact of envisaged policy measures can be quantified in order to achieve budgetary targets implied by fiscal rules.

E) MECHANISMS OF COORDINATION ACROSS GOVERNMENT SUB-SECTORS

As a first step, efforts to improve budgetary frameworks concerned central government level only. With the Directive, the scene is set for a broad-based extension of the principles for accounting, statistics, forecasting and fiscal rules to social security funds and state/local government, which taken together, account for a sizeable share of total expenditure. In particular, the Directive indicates that all measures adopted by Member States must be consistent across, and

comprehensive in the coverage of, all sub-sectors of general government. A clear delineation of budgetary responsibilities among government tiers is also required. National provisions should accordingly make sure that the constraints deriving from fiscal targets for general government are properly internalised by all government levels.

Beyond the establishment of fiscal rules for (or their extension to) sub-national governments, Member States report a variety of coordination instruments at different stages of the annual budgetary process. Finally, approximately one quarter of the Member States are considering adaptations to their coordination arrangements.

Box 1.2.1: National budgetary frameworks on the move

This box presents the reforms adopted since 2011 in selected countries to improve national budgetary frameworks in line with the Directive: three euro area Member States (Austria, France, Spain) and two non-euro area Member States (Bulgaria, Slovakia) are included.

In the case of **Austria**, the reinforcement of the Internal Stability Pact represents a positive step towards a strengthened budgetary framework. In May 2012, a new and comprehensive Internal Stability Pact was signed by all levels of government. The key element of the pact is the introduction of a new system of multiple fiscal rules covering also states and municipalities. The main rules involve: a) more stringent deficit targets have been set in last year Austria Stability Programme; b) a structural balance rule has been introduced and will apply from 2017 onwards, with a lower limit of general government structural deficit of -0.45% of GDP (-0.35% for the central government and -0.1% for states and municipalities); c) in line with the preventive arm of the Stability and Growth Pact, the expenditure growth of all government levels (net of discretionary measures) must not exceed average potential growth and ensure an appropriate adjustment path towards the Medium-Term Objective; d) enhanced enforcement mechanisms based on sanctions have been introduced to ensure the credibility of these provisions. In the health sector central and subnational governments agreed on holding down health expenditure on a dampening path, by the introduction of an expenditure benchmark equal to average nominal GDP growth until 2016, while from 2016 onwards health expenditure growth should not exceed 3.6%. The extension of tighter fiscal rules to subnational governments, the introduction of enforcement mechanisms and the adoption of specific targets to contain health expenditure dynamic are expected to contribute to spending efficiency.

Bulgaria has recently strengthened its fiscal framework. A new public finance law was adopted in January 2013 and will enter into force in 2014. It confirms the existing numerical fiscal rules – including nominal deficit ceiling and expenditure ceiling as % of GDP. It introduces additional rules related to the Stability and Growth Pact: a medium term ceiling for the structural deficit of the general government at 0.5% of GDP (1% in case debt is under 40%) and as a limit to public expenditure growth. Requirements at the municipal level are strengthened with the alignment of accounting and statistics systems with the Eurostat methodology. In addition, the new law reforms the three-year medium term budgetary framework and commits the government to submitting to the Parliament a proposal on the designation of an independent body in charge of monitoring the national numerical fiscal rules by mid-2013.

France has significantly reformed its budgetary framework in the past years, and more recently by the adoption in December 2012 of an organic law on budgetary planning and governance (*Loi organique relative à la programmation et à la gouvernance des finances publiques*). A budget balance rule expressed in structural terms has been established along with a correction mechanism that would be triggered in case of significant deviations from the country's medium-term objective, unless exceptional circumstances are called. The *Haut Conseil des Finances Publiques* was created in order to monitor the compliance with the fiscal rules and assess the forecasts underlying the budget documents. It is lodged in the Court of Auditors and headed by its first President. Its board members have a five-year mandate. Only board members coming from the staff of the Court of Auditors can be re-appointed. The first council's opinion on macroeconomic forecasts underlying the French 2013-2017 Stability Programme was published in April 2013. First adopted in February 2009, multi-annual public finance planning acts (*Lois de programmation des finances publiques*) are the main vehicle for multiannual planning. They include expenditure ceilings for the state at a disaggregated level over a three-year horizon. The multi-annual public finance planning act for 2012 to 2017 was approved in December 2012 and includes objectives on debt reduction and achievement of a structural budget balance in 2016 and 2017.

In **Slovakia**, a constitutional law on fiscal responsibility entered into force in March 2012. It has established automatic correction mechanism and specific sanctions in case the debt ceiling of 60% of GDP is breached and, as from 2018, the debt ceiling and the intermediate alert thresholds have to be reduced annually by one percentage point down to 50% of GDP in 2027. Escape clauses may apply in the event of a major recession, a banking system bailout, a natural disaster and international guarantee schemes. The introduction of more

(Continued on the next page)

Box (continued)

binding multiannual expenditure ceilings for the general government sector excluding the local government is also envisaged. The new Fiscal Responsibility Law also establishes an independent fiscal institution. The Council for Budgetary Responsibility started operating in the second half of 2012 and has already published several reports, including an assessment of the 2013-15 draft budget and a report on the long term sustainability of public finances. Its mandate includes the monitoring of national numerical fiscal rules, the monitoring of budgetary developments, the review of legislative budget proposals and the annual assessment of the long-term sustainability of public finances.

In **Spain**, the fiscal framework was significantly reformed in 2011-12, with the introduction of new fiscal principles in the Constitution (in particular, a balanced budget principle) and the adoption in April 2012 of an implementing Organic Law on Budgetary Stability and Financial Sustainability (*Ley Organica de Estabilidad Presupuestaria y de Sostenibilidad Financiera*). For example, supplementing existing numerical fiscal rules, a budget balance rule, a debt rule and an expenditure rule for the general government sector have been defined in the Organic Law along with specific escape clauses and mechanisms to correct potential deviations. The Organic Law also aims at reinforcing the budgetary responsibility across sub-sectors of the general government. For example, the overall debt ceiling of 60% of GDP is broken down into disaggregated ceilings for central government (44%), regions as a whole (13% of GDP), and local government as a whole (3%). The correction mechanisms also involve the sub-sectors, requiring the government level responsible for the deviation to submit its correction plans and allowing a temporary, partial or total handover of budgetary responsibility to a higher government level in the event of repeated unjustified deviations. In addition, following the ratification of the TSCG, Spain is currently preparing the establishment of an independent fiscal institution whose responsibilities would include the monitoring of national numerical fiscal rules at all government levels, as well as the endorsement of macroeconomic forecasts.

ANNEX 1 OVERVIEW OF COUNCIL RECOMMENDATIONS RELATING TO FISCAL POLICY

1. AT

Summary assessment

The Council is of the opinion that Austria undertook considerable consolidation efforts to bring the budget on a path to correct the excessive deficit. With regard to the 2013 programme, the macroeconomic scenario underpinning the budgetary projections is optimistic. The main objective of the budgetary strategy outlined in the programme is to gradually reduce the general government deficit to reach a balanced budget in nominal terms by 2016 and to meet the medium-term objective (MTO) by 2015. The programme confirms the previous MTO of a structural deficit of 0.45% of GDP. The MTO is in line with the requirements of the Stability and Growth Pact. Based on current projections, Austria is on track to correct its excessive deficit by 2013 given that the general government deficit is at 2.5% of GDP in 2012 and is expected to further decrease to 2.2% of GDP in 2013 and to 1.8% of GDP in 2014 respectively according to the Commission forecast. However, there are possible additional costs relating to the unwinding of a large bank which could have a significant deficit-increasing impact. After a strong improvement exceeding the adjustment path required in the EDP in 2012, the structural balance deficit is projected to increase in 2013 up to 1.8%. A slight increase of the structural deficit in 2013 is confirmed also by the Commission forecast. According to the information of the programme from 2014 onwards, the recalculated structural balance foresees a structural adjustment exceeding 0.5% in 2014 and 2015 enabling Austria to reach the MTO two years in advance in comparison to the scenario presented in the programme, i.e. in 2015 instead of 2017. As for the expenditure benchmark according to the information provided in the programme the growth rate of government expenditure, net of discretionary measures, over years 2014 and 2016 is to be in transition period from 2014 to 2016 regarding compliance with the debt criterion and plans would ensure sufficient progress towards compliance.

The strengthening of the budgetary framework has left the fiscal relations between layers of government largely unchanged and overlapping responsibilities and inconsistencies between funding and spending responsibilities remain a challenge. The complex mechanism of continuous agreements between the national government, social insurance providers and the sub-federal level, constitute an implementation risk to measures aimed at containing health expenditure. In education, the negotiations on a 6-point proposal including the abolition of school authorities at district level are a welcome step towards streamlining of responsibilities between different layers of government, but further simplification would be needed to reduce fragmentation more substantially.

Recommendation

- Implement the budget for the year 2013 as envisaged so as to correct the excessive deficit in a sustainable manner and achieve the average annual structural adjustment effort specified in the Council recommendations under the Excessive Deficit Procedure. After correction of the excessive deficit, pursue the structural adjustment effort at an appropriate pace so as to reach the MTO by 2015. Streamline fiscal relations between layers of government, for example simplifying the organisational setting and aligning spending and funding responsibilities.
- Bring forward the harmonisation of pensionable age for men and women, increasing the effective retirement age by aligning retirement age or pension benefits to changes in life expectancy implement and monitor the recent reforms restricting access to early retirement and further improve older workers' employability in order to raise the effective retirement age and the employment rate of older workers.
- Effectively implement the recent reforms of the health care system to make sure that the expected cost efficiency gains materialise. Develop a financially sustainable model for the provision of long-term care and put a stronger focus on prevention, rehabilitation and independent living.

2. BE

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible. In comparison to the Commission's 2013 Spring Forecast, which projects GDP growth to be flat in 2013 and to increase to 1.2% in 2014, it is slightly more optimistic (projecting 0.2% and 1.5%, respectively). Since 2010, Belgium has implemented consolidation measures, especially in 2012, and, also in 2012, introduced structural reforms in the pension system, the unemployment benefit system and product markets. However, the fiscal effort was not sufficient to be in line with the Council recommendation of 2 December 2009 to end the excessive deficit situation. Also in light of the recapitalisation of the banking group Dexia, which had a negative impact of 0.8% of GDP on the deficit outcome, and the worse than expected economic developments in the second half of 2012, the deadline for correction of the excessive deficit has been missed. As the correction of the excessive deficit by 2012 has not been achieved, the deficit is now foreseen to be brought below 3% of GDP from 2013. The objective of the budgetary strategy outlined in the programme is to reach a balanced budget in structural terms by 2015 and to achieve the medium-term objective (MTO) the year after. The programme has changed the MTO from a surplus of 0.5% to 0.75% of GDP. The new MTO is in line with the requirements of the Stability and Growth Pact. The programme is compatible with the new EDP deadline of 2013, but according to the Spring Forecast the safety margin against breaching the Treaty reference value is narrow, with a deficit projected at 2.9% of GDP in 2013. The planned annual progress towards the MTO, which is projected to be reached by 2016, is higher than 0.5% of GDP (in structural terms). No consolidation measures have been specified beyond 2013. According to the information provided in the programme, the growth rate of government expenditure, net of discretionary revenue measures, over 2014-2016 is expected to contribute to an annual structural adjustment towards the MTO by 0.5% of GDP. According to the programme, the debt ratio will peak at 100.0% of GDP in 2013 and will decline

gradually to 93.0% of GDP by 2016. From 2014 to 2016, Belgium can be expected to be in a transition period regarding compliance with the debt criterion. According to the plans, the debt benchmark will be met at the end of the transition period. Based on the Commission 2013 Spring Forecast, which projects the debt ratio to reach 101.4% in 2013 and to rise further to 102.1% of GDP in 2014 under a no-policy-change assumption, the transition towards the debt reduction rule will not be respected in 2014, which indicates that progress towards the MTO is not sufficient. The programme does not explain how the planned adjustment will be shared between the different layers of government, an issue also addressed in last year's country specific recommendation. In addition to a rules-based multi-annual framework for general government, it is necessary to design and agree on explicit coordination arrangements to secure and enforce more robust, automatic commitments from the regions, communities and local authorities, to meet budgetary targets.

Recommendation

- Adopt additional measures to achieve the structural adjustment effort specified in the Council Decision to give notice to correct the excessive deficit by 2013 and to enhance the sustainability and credibility of the consolidation. A durable correction of the fiscal imbalances requires the credible implementation of ambitious structural reforms which would increase the adjustment capacity and boost potential growth. After the correction of the excessive deficit, pursue the structural adjustment at an appropriate pace so as to reach the medium-term objective by 2016 and ensure that the high debt ratio is put on a firm downward path. To this end, present growth friendly structural measures for 2014 by 15 October 2013 which ensure a sustainable correction of the excessive deficit and sufficient progress towards its medium-term objective. Ensure that the adjustment path is balanced over time or even front-loaded. Adopt explicit coordination arrangements to ensure that budgetary targets are binding at federal level and sub-federal levels within a medium-term planning perspective including through the prompt adoption of a rule on the general government budget

balance/surplus that complies with the requirements of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and to increase the transparency of burden sharing and accountability across government layers.

- Step up efforts to close the gap between the effective and statutory retirement age, including by pursuing the on-going reforms to reduce the out early-exit possibilities. Underpin reforms of the old-age social security systems with employment-support measures and labour-market reforms conducive to active ageing. Increase the effective retirement age by aligning retirement age or pension benefits to changes in life expectancy.

3. BG

Summary assessment

The Council is of the opinion that public finances in Bulgaria have overall been sound. The medium-term objective (MTO) was reached in 2012. The macroeconomic scenario underpinning the budgetary projections in the convergence Programme is plausible for the 2013-14 period, when annual growth is expected to reach 1.0% in 2013 and 1.8% in 2014. The Commission 2013 spring forecast foresees a GDP growth of 0.9% in 2013 and of 1.7% in 2014. The objective of the budgetary strategy outlined in the programme is to keep the structural budget balance close to the MTO throughout the programme period. The programme confirms the previous MTO of -0.5% of GDP which is more ambitious than required by the Stability and Growth Pact. Based on the (recalculated) structural budget balance, which is estimated to weaken slightly from a deficit of 0.4% of GDP in 2012 to between 0.7-0.8% of GDP over 2013-2016. Bulgaria falls marginally below its MTO over the Convergence Programme period. In 2013-15, the growth rate of government expenditure, taking into account discretionary revenue measures, would respect the expenditure benchmark of the Stability and Growth Pact, yet breach it in 2016. The debt ratio is below 60% of GDP and, according to the Convergence Programme, it is expected to peak at 20.4% of GDP in 2014 and then to decrease over the Programme period. Similarly, the Commission

2013 spring forecast foresees the debt ratio to amount to 20.3% of GDP in 2014.

Recommendation

- Preserve a sound fiscal position by ensuring compliance with the medium-term objective and pursue a growth-friendly fiscal policy as envisaged in the convergence programme. Implement a comprehensive tax strategy to strengthen all aspects of the tax law and collection procedures with a view to increase revenue, notably by improving tax collection, tackling the shadow economy and reducing compliance costs. Establish an independent institution to monitor fiscal policy and provide analysis and advice.

- Phase out early retirement options, introduce the same statutory retirement age for men and women and implement active labour market policies that enable older workers to stay longer in the labour market. Tighten the eligibility criteria and controls for the allocation of invalidity pensions to effectively limit abuse.

4. CY

Detailed Recommendations are set out in the Memorandum of Understanding.

5. CZ

Summary assessment

The Council is of the opinion that the Czech Republic has reduced the headline deficit by 1.4% (1)of GDP from 2009 to 2012 due to substantial consolidation efforts and that, based on current expectations; it is on track to correct the excessive deficit. The macroeconomic scenario underpinning the budgetary projections in the programme is plausible. According to the convergence programme, real GDP growth is expected to be at 0% and 1.2% in 2013 and 2014, respectively, compared to -0.4% and 1.6 % in 2013 and 2014 respectively in the Commission 2013 spring forecast. The objective of the budgetary strategy outlined in the programme is to keep the general government deficit below the 3% of GDP reference value. The general government deficit target of 2.% of GDP in 2013 is in line with the

deadline for correcting the excessive deficit set out in the Council recommendation of 2 December 2009. The Commission 2013 spring forecast projects the government deficit at 2.9% and 3% of GDP in 2013 and 2014, respectively. There is a risk of worse-than-expected budgetary outcome in 2013 stemming from additional corrections in EU funds reimbursements. On the positive side, one-off revenues related to the planned auction of new telecom frequency bands could result in a better than- expected budgetary outcome in 2013. The convergence programme confirms the previous medium-term objective of a deficit of 1% of GDP, which adequately reflects the requirements of the Stability and Growth Pact. The (recalculated) structural budget deficit is projected to increase by 0.3%, 0.2% and 0.5% of GDP in 2014, 2015 and 2016 respectively; therefore no adjustment towards the medium-term objective is foreseen in the programme, which is not in line with the Stability and Growth Pact. The rate of growth of government expenditure complies with the expenditure benchmark of the Stability and Growth Pact in 2014 but deviates by 0.3% and 0.5% of GDP in 2015 and 2016 respectively. According to the convergence programme, the debt-to-GDP ratio is forecast to continue to increase over the programme period, albeit at a slowing pace, and to reach 51.9% of GDP in 2016.

Recommendation

- Implement as envisaged the budget for the year 2013 so as to correct the excessive deficit in 2013 in a sustainable manner and achieve the structural adjustment effort specified in the Council recommendations under the EDP. For the year 2014 and beyond, reinforce and rigorously implement the budgetary strategy, supported by sufficiently specified measures, to ensure an adequate fiscal effort to make sufficient progress towards the medium-term objective. Prioritise growth-enhancing expenditure including committing on time remaining projects co-financed with EU funds under the current financial framework.
- Increase the effective retirement age by aligning retirement age or pension benefits to changes in life expectancy, and review the indexation mechanism. Accompany the increase in retirement

age with measures promoting employability of older workers and reduce early exit pathways. In particular, remove the public subsidy for the pre-retirement scheme. Take measures to significantly improve cost-effectiveness of healthcare expenditure, in particular for hospital care.

- Take additional efforts to strengthen the efficiency and effectiveness of the public employment service. Increase significantly the availability of inclusive childcare facilities with a focus on children up to three years old, and the participation of Roma children, notably by adopting and implementing the law on provision of childcare services and strengthening the capacities of both public and private childcare services.

6. DE

Summary assessment

The Council is of the opinion that public finances in Germany have been overall sound and the medium-term budgetary objective (MTO) has been achieved. The macroeconomic scenario underpinning the budgetary projections in the programme is plausible. The stability programme's macroeconomic projections are broadly in line with the Commission's 2013 spring forecast as regards the pace and pattern of economic growth in 2013 and 2014 as well as with the Commission's estimate of Germany's medium-term potential growth rate. The objective of the budgetary strategy outlined in the programme is to ensure continued achievement of the medium-term budgetary objective (MTO). The programme confirms the previous MTO of -0.5 % of GDP. The MTO is in line with the requirements of the Stability and Growth Pact. Germany achieved a structural budgetary surplus and hence the MTO in 2012. According to the stability programme, the (recalculated) (2) structural balance will remain positive in 2013 and 2014, which is broadly in line with the Commission's forecast, and hence created space for automatic stabilisers to play freely. Germany also complied with the expenditure benchmark in 2012. According to the information provided in the stability programme, the growth rate of government expenditure, net of discretionary revenue measures, would exceed the expenditure benchmark in 2013, while respecting

it in 2014. The programme plans gross debt to fall to 80½ % of GDP in 2013 and to remain on a downward path thereafter. Following the correction of the excessive deficit in 2011, Germany is in a transition period regarding compliance with the debt criterion and made sufficient progress towards compliance with the debt criterion in 2012. If the programme is implemented as planned, it is also making sufficient progress towards compliance with the debt criterion in 2013 and the debt benchmark will be met at the end of the transition period in 2014. Overall, the deficit and debt targets appear realistic.

Recommendation

- Preserve a sound fiscal position as envisaged which ensures compliance with the medium-term objective over the programme horizon. Pursue a growth-friendly fiscal policy through additional efforts to enhance the cost-effectiveness of public spending on healthcare and long-term through better integration of care delivery and a stronger focus on prevention and rehabilitation and independent living. Improve the efficiency of the tax system, in particular by broadening the VAT base and by reassessing the municipal real estate tax base; use the available scope for increased and more efficient growth-enhancing spending on education and research at all levels of government. Complete the implementation of the debt brake in a consistent manner across all Länder, ensuring that monitoring procedures and correction mechanisms are timely and relevant.

7. DK

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible. The scenario projecting GDP growth at 0.7% and 1.6% in 2013 and 2014 is broadly in line with the Commission's 2013 spring forecast of 0.7% and 1.7%. The programme outlines a budgetary strategy aimed at correcting the excessive deficit and to fulfil its medium-term objective (MTO), of a structural deficit of no more than 0.5% of GDP, by 2013, reflecting the

objectives of the Pact. The programme targets a general government deficit of 1.7% of GDP in 2013 and 1.8% in 2014, which is in line with the EDP deadline proposed by the Commission. The average annual fiscal effort over the period 2011-2013, based on the structural budget balance calculations, is in line with the Council recommendation under the excessive deficit procedure. In the Convergence Programme net discretionary measures are estimated to yield a consolidation broadly in line with the recommendation issued under the excessive deficit procedure. The real government expenditure (including discretionary income measures) is estimated to show zero growth in 2013 and to be at 0.4% in 2014, thus meeting the expenditure benchmark in both years. Public finances in Denmark are generally sound and the country is already at its MTO. However, also because the country has an ageing population and ambitious welfare policies, it is crucial for Denmark to maintain a sound and sustainable framework for fiscal policies and to keep the deficit below the 3 % of GDP reference value in the Treaty.

Recommendation

- Implement the budgetary strategy in 2013 as envisaged, so as to ensure the correction of the excessive deficit by 2013. Furthermore, implement the budgetary strategy for 2014 and beyond to ensure an adequate fiscal effort to remain at the medium-term objective.

8. EE

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible in 2013-2014 when real GDP growth is expected to average around 3.3%. The Commission 2013 spring forecast foresees growth of 3.5% in 2013-2014. Estonia achieved a headline budget deficit of 0.3% of GDP in 2012. The programme confirms the previous medium-term objective (MTO) of a structural surplus. This is more ambitious than required by the Stability and Growth Pact. As Estonia's structural balance was in surplus in 2012, the country achieved its MTO

one year earlier than foreseen in its previous programme. The objective of the budgetary strategy outlined in the Stability Programme is to ensure sustainable fiscal policy that supports balanced growth, by staying at the MTO while ensuring sufficient fiscal buffers and reducing the tax burden on labour. The planned headline deficit, 0.5% of GDP in 2013, is envisaged by the programme to improve over the forecast horizon, reaching balance in 2014 and moving into surplus thereafter. Following an overall assessment of the recalculated structural balance, including an analysis of expenditure benchmark, Estonia does not deviate significantly from the MTO in 2013, returning to a structural surplus in 2014. The debt ratio is well below 60% of GDP and, according to the programme, is likely to decrease after 2013 to about 9% in 2015-2016. Estonia plans to introduce a structural budget balance rule in 2013, in line with the requirements of the Treaty on Stability, Coordination and Governance. The rule should be complemented by strengthening the binding nature of the multiannual expenditure targets as soon as the budget rule is in place.

Recommendation

- Pursue a growth-friendly fiscal policy and preserve a sound fiscal position as envisaged, ensuring compliance with the medium-term budgetary objective over the programme horizon. Complement the planned budget rule with more binding multiannual expenditure rules within the medium-term budgetary framework and continue enhancing the efficiency of public spending.

9. EL

Detailed Recommendations are set out in the Memorandum of Understanding.

10. ES

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is broadly plausible for 2013 and subject to some downside risks in 2014 and beyond compared with the Commission's 2013 spring forecast. Although the

programme projects growth to be lower over the 2014-16 period compared to the Commission's 2013 spring forecast, the latter is based on a no-policy-change assumption and hence does not take into account the fiscal consolidation that will be needed to attain the budgetary targets in the programme. The objective of the budgetary strategy outlined in the programme is to bring the general government deficit below the 3% of GDP reference value by 2016. The consolidation relies mainly on expenditure restraint with the expenditure ratio decreasing by 3.7 percentage points over the 2012-16 period, but also on some revenue-increasing measures. Based on the (recalculated) structural balance (1) the annual improvement of the structural deficit planned in the programme is 1.2%, 0.4%, 0.9% and 0.9% of GDP for the years 2013 to 2016. Following the correction of the excessive deficit, the programme confirms the medium-term objective (MTO) of a balanced budgetary position in structural terms, which would be achieved by 2018. The MTO is more ambitious than required by the Stability and Growth Pact. The envisaged pace of adjustment in structural terms in 2017-18 represents sufficient progress towards the MTO. The programme projects the government debt ratio to peak in 2016 and to start declining thereafter. The deficit and debt adjustment paths are subject to downside risks. Measures to support the deficit targets are not sufficiently specified, especially at regional level. For 2016 the programme does not present any measures and previous temporary measures are extended only to 2014. Planned savings from the local government reform are subject to significant implementation risks. Moreover, there are uncertainties surrounding the economic, labour market and financial situation as well as revenue developments in the context of persisting large macroeconomic imbalances. Fully implementing the adopted early retirement reform and reaching an agreement on the sustainability factor would mitigate risks in the social security system. A further risk stems from contingent liabilities linked with asset protection schemes/guarantees. There were major progress in the reporting of budgetary execution, but there is scope for a more transparent and timely implementation of the Budgetary Stability Law's preventive and corrective mechanisms. Systematic and timely reporting on government arrears, whose large outstanding stock

required an ad-hoc repayment scheme, is missing. The establishment of an independent fiscal council has been lagging behind schedule. A proposed revision of indexation rules for all public revenues and expenditures would bring budgetary savings and a higher responsiveness of prices to economic conditions. The NRP also acknowledges the need to further improve cost-effectiveness in healthcare and pharmaceutical expenditure, e.g. by revising reference prices and centralising purchasing of pharmaceutical products, or extending co-payments.

Recommendation

- Deliver the structural fiscal effort as required by the Council recommendation under the EDP to ensure correction of the excessive deficit by 2016. To this end, implement the measures adopted in the 2013 budget plans at all levels of government, reinforce the medium-term budgetary strategy with sufficiently specified structural measures for the years 2014-16. A durable correction of the fiscal imbalances is predicated upon the credible implementation of ambitious structural reforms which would increase the adjustment capacity and boost potential growth and employment. After achieving the correction of the excessive deficit, pursue the structural adjustment at an appropriate pace so as to reach the medium term objective by 2018. Ensure a strict and transparent enforcement of the preventive and corrective measures provided for in the Budgetary Stability Organic Law. Establish an independent fiscal authority before the end of 2013 to provide analysis, advice and monitor compliance of fiscal policy with national and EU fiscal rules. Improve the efficiency and quality of public expenditure at all levels of government, and conduct a systematic review of major spending items by March 2014. Increase the cost effectiveness of the health-care sector, while maintaining accessibility for vulnerable groups, for example by reducing hospital pharmaceutical spending, strengthening coordination across types of care and improving incentives for an efficient use of resources. Take measures to reduce the outstanding amount of government arrears, avoid their further accumulation and regularly publish data on outstanding amounts. Adopt the dis-indexation law to reduce the degree of price inertia in public expenditures and revenues, in time to

have it in force by the beginning of 2014 and consider additional steps to limit the application of indexation clauses. Finalise by end-2013 the regulation of the sustainability factor so as to ensure the long-term financial stability of the pension system, including by increasing the effective retirement age by aligning retirement age or pension benefits to changes in life expectancy.

- Adopt in line with the presented timetable the reform of the local administration and define by October 2013 a plan to enhance the efficiency of the overall public administration. Adopt and implement the on-going reforms to enhance the efficiency of the judicial system.

11. FI

Summary assessment

The Council is of the opinion that the public finances in Finland have been overall sound and efforts have been made to increase revenues and to control expenditures in order to move towards the medium-term objective (MTO). The macroeconomic scenario underpinning the budgetary projections in the programme is plausible. The growth projection for 2013 is similar to the Commission's spring forecast, whereas the one for 2014 is 0.6 pp higher than in the Commission's forecast. The objective of the budgetary strategy outlined in the programme is to balance the central government finances and to bring the central government debt to GDP ratio on a declining path by 2015. The programme incorporates a change in the medium-term objective (MTO) from 0.5% to -0.5%. The new MTO is in line with the requirements of the Stability and Growth Pact. The programme foresees reaching the MTO by 2014 and staying at the MTO until 2017. Based on the (recalculated) structural balance on the basis of information in the programme, Finland did not meet in 2012 the previously-applicable MTO and would not meet the new MTO in 2013. The programme projects the (recalculated) structural balance to improve from -1% of GDP in 2012 to -0.9% of GDP in 2013. Between 2014 and 2017, it would remain between -0.6% and -0.7% of GDP. In 2012, Finland's net expenditure increased by 0.4%, which remains below the applicable reference rate

of the expenditure benchmark. Due to the negative real GDP growth in 2012, the low structural adjustment is deemed sufficient. In 2013, Finland's (recalculated) structural balance is improving and its net expenditure is projected to deviate by only 0.1% of GDP from the expenditure benchmark. In the light of Finland's large negative output gap this is deemed to be appropriate. In 2014, Finland's (recalculated) structural balance is forecast to improve further, reaching -0.6% of GDP, thus getting sufficiently close to the MTO (moreover, according to the Commission's spring forecast Finland would fully reach it in 2014). Overall, this would entail compliance with the preventive arm of the Stability and Growth Pact. General government gross consolidated debt was 53% of GDP in 2012 and will remain, according to the programme, below 60% of GDP over the programme horizon. The programme foresees reductions in the debt level in 2016 and 2017. Long-term sustainability continues to be the most important challenge for fiscal policy. The ageing related sustainability gap, concerning pensions, healthcare and long-term care, has been recognised and needs constant monitoring.

Recommendation

- Pursue a growth-friendly fiscal policy and preserve a sound fiscal position as envisaged, ensuring compliance with the MTO over the programme horizon. Continue to carry out annual assessments of the size of the ageing-related sustainability gap and adjust public revenue and expenditure in accordance with long-term objectives and needs. Ensure the cost-effectiveness and sustainability of long-term care and put a stronger focus on prevention, rehabilitation and independent living.
- Ensure effective implementation of the on-going administrative reforms concerning the municipal structure, in order to deliver productivity gains and cost savings in the provision of public services, including social and healthcare services.

12. FR

Summary assessment

The Council is of the opinion that despite considerable consolidation efforts that brought the headline deficit down from 7.5 % of GDP in 2009 to 4.8 % in 2012, France is not expected to correct its excessive deficit by 2013 as recommended by the Council in late 2009. This is linked notably to a worse economic environment than expected at the time the recommendation was made which was only partly compensated by windfall revenues, while the effort was somewhat back loaded. The macroeconomic scenario underpinning the budgetary projections in the programme is plausible for 2013 but overly optimistic for 2014. In particular, the authorities anticipate that after a standstill in 2012 (0%) and in 2013 (+0.1%), GDP will grow by 1.2% in 2014 while assuming that fiscal measures are taken to bring the general government deficit to 2.9% of GDP. By comparison, the Commission forecasts that GDP will grow by 1.1% in 2014 based on a no-policy-change assumption, a scenario which only takes into account measures that have been adopted or sufficiently specified and hence forecasts a deficit of 4.2% of GDP. The main objective of the budgetary strategy outlined in the programme is to achieve the medium-term objective (MTO), which is a balanced budget in structural terms, as in last year's programme. This is more ambitious than required by the Stability and Growth Pact. The target year for reaching the MTO is 2016, compared with 2015 in the previous stability programme. The planned headline deficit set by the stability programme is consistent with a correction of the excessive deficit by 2014, one year after the revised deadline set by the Council under the excessive deficit procedure in late 2009. Given the overly optimistic growth forecast in the programme for 2014, unless additional measures are taken to substantially reinforce the effort for that year, the Council considers that the fiscal effort envisaged by the authorities is not compatible with an actual correction of the excessive deficit by 2014. Planned savings and additional revenue also lack specifics. In these circumstances, measures need to be specified for both 2014 and 2015 to credibly ensure that the excessive deficit is corrected by 2015 at the latest [as recommended by the Council]. In 2016, the structural balance, as recalculated by the Commission, is expected to be -0.4 % of GDP (-0.3 % in 2017) and thus the MTO would not be

reached by the end of the programme horizon. Progress towards the MTO in that year is expected to represent 0.3% of GDP, which is below the 0.5% of GDP benchmark. The general government debt has increased substantially since the beginning of the crisis. Starting from 64.2% in 2007, the ratio of debt to GDP reached 90.2% in 2012 and is projected to increase further to 96.2% by 2014 according to the Commission services' 2013 Spring Forecast. The authorities expect the debt ratio to peak at 94.3% of GDP in 2014 and then to drop to 88.2% in 2017. France will be in a transition period from 2016 regarding compliance with the debt criterion.

Recommendation

- Reinforce and pursue the budgetary strategy in 2013. Enhance the credibility of the adjustment by specifying by autumn 2013 and implementing the necessary measures for the year 2014 and beyond to ensure a correction of the excessive deficit in a sustainable manner by 2015 at the latest and the achievement of the structural adjustment effort specified in the Council recommendations under the EDP. Use all windfall gains for deficit reduction. A durable correction of the fiscal imbalances requires a credible implementation of ambitious structural reforms to increase the adjustment capacity and boost growth and employment. Maintain a growth-friendly fiscal consolidation course and further increase the efficiency of public expenditure, in particular by proceeding as planned with a review of spending categories across all sub-sectors of general government. Take action through the forthcoming decentralisation law to achieve better synergies and savings between central, regional and local government levels. After the correction of the excessive deficit, pursue the structural adjustment effort at an adequate pace so as to reach the MTO by 2016. Take measures by the end of 2013 to bring the pension system into balance in a sustainable manner no later than 2020, for example by adapting indexation rules, by increasing the full-pension contribution period, by further increasing the effective retirement age by aligning retirement age or pension benefits to changes in life expectancy and by reviewing special schemes, while avoiding an increase in employers' social contributions, and increase the cost-effectiveness

of healthcare expenditure, including in the areas of pharmaceutical spending.

13. HU

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the Programme is somewhat optimistic. The Hungarian authorities' growth projections for 2013 and 2014 of 0.7% and 1.9% are higher by around half a percentage point compared to the Commission 2013 spring forecast. The objective of the budgetary strategy outlined in the programme is to ensure the sustainable correction of the excessive deficit by the 2012 deadline and the continued respect of the medium-term objective (MTO). Hungary has undertaken significant fiscal efforts in 2012 and with a budget deficit outcome of 1.9% of GDP overachieved the deficit target of 2.5% of GDP recommended by the Council, partly on account of additional one-off revenues of 0.2% of GDP on top of those which were acknowledged already at the time of the Council recommendation. However, the corrective measures for 2012 and beyond, notably those announced in the autumn of 2012 were mainly concentrated on the revenue side, primarily focusing on selected sectors, raising questions about the sustainability of the consolidation efforts. According to the Commission 2013 spring forecast further efforts are needed for both 2013 and 2014 in order to correct the excessive deficit in a sustainable manner. Following the publication of the spring forecast the government adopted a new corrective package, and based on the updated assessment of the Commission, the deficit is projected to remain below the 3% of GDP threshold with the new measures in both 2013 and 2014. The programme has changed the MTO from a structural balance of -1.5% to -1.7% of GDP. The new MTO is in line with the requirements of the Stability and Growth Pact. Hungary recorded a structural balance of -0.7% of GDP in 2012, i.e. well above its revised MTO, and the Commission 2013 spring forecast foresees the structural balance to stay in line with the MTO over the forecast horizon and to stand at -1.1% in 2013 and -1.8% in 2014. Based on the measures adopted after the Commission 2013 spring forecast the structural

balance could remain above the MTO in 2014 as well. The growth rate of government expenditure in 2013 and 2014, net of discretionary revenue measures, will be broadly in line with the reference medium-term rate of potential GDP growth, but is expected to significantly exceed it in 2015 and 2016. Thus, the expenditure benchmark will not be met in these two years. According to government plans, the public debt-to-GDP ratio will continuously decrease throughout the programme period from 79.2% in 2012 to 77.2% in 2014 and further to 73.4% in 2016, i.e. it will remain above the 60% of GDP reference value. In contrast, the Commission 2013 spring forecast, taking account of risks to the consolidation plans, expected only a marginal decrease to 78.9% of GDP in 2014 which should be around 0.5 pps lower with the new corrective measures. Hungary will be in a transition period from 2013 regarding compliance with the debt criterion, and according to the Commission 2013 spring forecast it is making sufficient progress towards compliance with the debt criterion in 2013 and 2014.

Recommendation

- Implement a credible and growth friendly fiscal strategy by specifying the necessary measures focusing on expenditure savings and preserve a sound fiscal position in compliance with the medium-term objective over the programme horizon. Building on the above steps, put the general government debt ratio on a firm downward path, also with a view to mitigating the accumulated macroeconomic imbalances. Enhance the medium-term budgetary framework by making it more binding and by closely linking it to numerical rules. Broaden the mandatory remit and enhance the transparency of the Fiscal Council, including through systematic ex-post monitoring of compliance with numerical fiscal rules as well as the preparation of regular macro-fiscal forecasts and budgetary impact assessments of major policy proposals.

14. IE

Detailed Recommendations are set out in the Memorandum of Understanding

15. IT

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is optimistic for 2014, when compared with the Commission 2013 spring forecast. It is plausible as from 2015, but this is under the assumption of the full implementation of the adopted structural reforms, which remains challenging. The budgetary strategy outlined in the programme was confirmed by the new government and endorsed by Parliament. It aims to maintain the deficit below 3% of GDP throughout the programme period, reach the medium-term objective (MTO) in 2013 and put the debt to GDP ratio on a declining path as from 2014. The programme confirms the MTO of a balanced budgetary position in structural terms, which is in line with the Stability and Growth Pact. The deficit was brought to 3% of GDP in 2012 and, according to the Commission 2013 spring forecast released on 3 May, is expected to remain below the reference value in 2013-14. The provisions adopted by the Italian government on 17 May are assessed to have no significant impact on the deficit, if consistently implemented. After improving by 2.7 percentage points of GDP in cumulative terms between 2009 and 2012, and assuming no further policy changes, the structural balance as a share of GDP is forecast to improve by a further percentage point in 2013, to -0.5%, and then deteriorate marginally in 2014. The structural primary balance would reach nearly 5% of GDP in 2014. The forecast structural adjustment for 2013 is appropriate, also based on an analysis of expenditure net of discretionary revenue measures, while for 2014 it shows a deviation from the adjustment path towards the MTO. The programme projects the government debt ratio to peak in 2013 and to start declining thereafter, also thanks to foreseen privatisation proceeds amounting to 1 percentage point of GDP per year. In the forecast however, the debt to GDP ratio continues increasing, also due to the settlement of commercial debt, which adds around 2.5 percentage points over 2013-14, while no privatisation proceeds are included as the details have not yet been specified. As from 2013, Italy is in a three year transition period regarding compliance with the debt criterion and the debt trajectory in the stability programme ensures

sufficient progress towards compliance with it. However, the deficit and debt projections in the programme are predicated upon full implementation of the budgetary measures and structural reforms adopted, which are essential to anchor market confidence and boost growth and jobs.

Recommendation

- Ensure that the deficit remains below 3% of GDP in 2013, by fully implementing the adopted measures. Pursue the structural adjustment at an appropriate pace and through growth-friendly fiscal consolidation so as to achieve and maintain the MTO as from 2014. Achieve the planned structural primary surpluses in order to put the very high debt-to-GDP ratio on a steadily declining path. Continue pursuing a durable improvement of the efficiency and quality of public expenditure by fully implementing the measures adopted in 2012 and taking the effort forward through regular in depth spending reviews at all levels of government.

16. LT

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible and broadly in line with the assessment in the Commission's spring forecast. Following an ambitious fiscal consolidation since 2009, the general government deficit has been brought to 3.2% of GDP in 2012, which is considered sufficient for abrogation of the decision on the existence of an excessive deficit, taking into account the cost of the systemic pension reform. The deficit reduction was to some extent also based on robust economic growth and temporary expenditure freezes. The programme has changed the medium-term objective (MTO) from +0.5% to -1.0%, which is still in line with the objectives of the Stability and Growth Pact. The budgetary strategy outlined in the programme aims to reach the MTO by 2016. Based on the (recalculated) structural budget balance, annual progress towards the MTO in structural terms is higher than 0.5% of GDP. The expenditure benchmark over the

programme period is met. The adjustment is slightly front-loaded and relies mainly on expenditure restraint, but is only partially supported by concrete measures, including one-offs that are not always specified. According to the Commission's forecast, the structural adjustment in 2013 and 2014 is expected to be at 0.3% and 0.0% of GDP respectively and thus below the required progress of 0.5% of GDP, which also casts doubt on the programme's adjustment path. Further consolidation measures have yet to be specified, and structural reforms including a shift to revenue based measures, should be considered. General government debt remains below 60% of GDP with 40.7% in 2012 and is expected to drop slightly over the programme period. While the convergence programme expects debt to ease to 39.7% in 2013 and to decline further to 34.5% by 2016, the Commission's forecast projects it to drop to 40.1% of GDP in 2013 and 39.4% in 2014. Differences are above all the result of lower assumed deficits in the convergence programme.

Recommendation

- Ensure growth friendly fiscal consolidation and implement the budgetary strategy as planned, pursuing a structural adjustment effort that will enable Lithuania to reach the medium-term objective. Prioritise growth-enhancing expenditure. Continue to strengthen the fiscal framework, in particular by securing enforceable and binding expenditure ceilings in the medium-term budgetary framework. Review the tax system and consider increasing those taxes that are least detrimental to growth, such as recurrent property and environmental taxation, including introducing car taxation, while continuing to reinforce tax compliance.
- Adopt and implement legislation on a comprehensive pension system reform. Align the statutory retirement age with life expectancy, restrict access to early retirement, establish clear rules for the indexation of pensions, and promote the use of complementary savings schemes while ensuring implementation of on-going reforms. Underpin pension reform with measures that promote the employability of older workers.

17. LU

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible. In particular, the programme scenario for 2013 is very close to the 2013 Commission spring forecast, while for 2014 it is slightly more optimistic. Medium-term deficit projections are made under a slightly optimistic growth scenario, above potential growth. The objective of the budgetary strategy outlined in the programme is to bring the deficit from 0.8% of GDP in 2012 to 0.6% of GDP in 2014. However in the outer years of the programme period, the deficit is forecast to deteriorate to 1.3% of GDP both in 2015 and 2016. This is the result of the introduction of the new VAT rules regarding electronic services, entering into force on 1 January 2015, which will bring Luxembourg into compliance with EU rules. According to these rules, the VAT revenues generated from e-commerce activities will be transferred from the country where the supplier is located to that of the residence of the customer. The impact of the new rules is estimated by the authorities to lower tax revenues from VAT by 1.4% of GDP. The government has already announced that the standard VAT rate will be increased, with a view to make up a part of the revenue loss. The 2013 Stability Programme confirms the previous medium-term budgetary objective (MTO) of a structural surplus of 0.5% of GDP. The MTO is in line with the requirements of the Stability and Growth Pact. Based on both the 2013 Commission spring forecast as well as on the (recalculated) structural budget balance in the programme, Luxembourg is expected to be at a structural surplus of 0.1% of GDP, which is below the MTO, in 2012, and is projected to achieve its MTO in 2013. However, Luxembourg is projected to depart again from its MTO starting from 2014 by 0.3% of GDP and even further in 2015 and 2016. The national authorities have reiterated their objective to return to the MTO at the latest in 2017 so as to provide greater room for manoeuvre. At 20.8% of GDP in 2012, gross government debt is well below the Treaty reference value.

Recommendation

- Preserve a sound fiscal position and remain at the medium-term objective so as to ensure the long-term sustainability of public finances, in particular by taking into account implicit liabilities related to ageing. Strengthen fiscal governance by adopting a medium-term budgetary framework covering the general government and including multi-annual expenditure ceilings, and by putting in place the independent monitoring of fiscal rules.

- Curb age-related expenditure by making long-term care more cost effective, in particular through a stronger focus on prevention, rehabilitation and independent living, strengthening the recently adopted pension reform, taking additional measures to curb early retirement and increasing the effective retirement age by aligning retirement age or pension benefits to change in life expectancy..

18. LV

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible. Economic growth is expected to slow down somewhat, to around 4% per year, over the programme period, while price increases are projected to remain moderate. The general government deficit declined in 2012 to a level well below 3% of GDP and the medium-term objective (MTO) was reached in that year, considerably earlier than what was foreseen in the previous programme. The programme confirms the previous MTO of -0.5%, which adequately reflects the objectives of the Pact. The objective of the budgetary strategy outlined in the programme is to maintain a structural budgetary position which is based on the MTO, with any deviation limited to the incremental impact of systemic pension reform; this reform entails a gradual increase in the share of social security contributions which is diverted to a funded pension scheme and is implemented in 2013, 2015 and 2016. However, following an overall assessment with the recalculated structural balance as a reference, including an analysis of expenditure net of discretionary measures, it appears that the structural balance is set to deviate from the MTO

by 1.0 pp. of GDP in 2013, i.e. significantly more than the incremental impact of the systemic pension reform, and by further 0.2 pp. in 2014. Government debt is set to remain well below 60% over the whole programme period, increasing from 40.7% of GDP in 2012 to 44.5% in 2013, as the government accumulates assets for debt repayments, and is declining from 2014 as repayments take effect, reaching 34.6% by the end of the programme period. The Fiscal Discipline Law was approved by the Latvian Parliament in January 2013 and entered into force in March 2013. If effectively implemented, the new law would considerably strengthen the fiscal framework in Latvia, providing an effective mechanism to limit expenditure growth in good economic times and serving as a basis for rules-based multi-annual budgeting.

Recommendation

- Reinforce the budgetary strategy to ensure that the deviation from the MTO only reflects the incremental impact of the systemic pension reform. Within this strategy, reduce taxation of low-income earners by shifting taxation to areas such as excise duties, recurrent property taxes and/or environmental taxes. Maintain efforts to improve tax compliance and combat the shadow economy. Continue strengthening the fiscal framework through effective implementation of the Fiscal Discipline Law and multi-annual budgeting.

19. MT

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible. The Council abrogated its decision on the existence of an excessive deficit in Malta on 4 December 2012, on account of its correction in 2011, which based on the Commission's 2012 autumn forecast appeared durable. However, in 2012 Malta recorded a general government deficit of 3.3% of GDP, again above the reference value of 3% of GDP. The objective of the budgetary strategy outlined in the programme is to gradually reduce the deficit from 3.3% of GDP in 2012 to

0.8% of GDP in 2016, implying gradual progress towards the medium-term objective. The programme confirms the medium-term objective of a balanced position in structural terms, which is more ambitious than required by the Stability and Growth Pact, but its achievement is not planned within the programme period. The 2013 deficit target in the programme relies on relatively high growth in tax revenues, which does not appear to be fully explained by the underlying macroeconomic scenario. In addition, it is not sufficiently supported by detailed measures, as is also the case for the subsequent years. As a result, the change in the planned (recalculated) structural balance is significantly higher than in the Commission's forecast. According to the latter, the structural balance improves by just ¼ pp. of GDP in 2013 and only marginally in 2014, on a no-policy-change basis. General government debt is projected to remain above the 60% of GDP threshold over the whole programme horizon. The national authorities project the debt to increase to 74.2% of GDP in 2014 and subsequently to start decreasing to 70% by 2016. In the Commission's 2013 spring forecast, the debt to- GDP ratio is expected to increase slightly faster, to 74.9% in 2014, as the primary deficit is expected to continue expanding. Given the correction of the excessive deficit in 2011, Malta is in a three-year transition period as regards the applicability of the debt reduction benchmark, starting in 2012. Malta did not make sufficient progress towards compliance with the debt criterion in 2012 and is not projected to do so in 2013-14. While Malta's fiscal framework is quite flexible, its non-binding nature and the short horizon of fiscal planning are not supportive of a sound fiscal position. Directive 2011/85/EU on budgetary frameworks has not yet been transposed and a structural budget balance rule, as provided for in the Treaty on Stability, Coordination and Governance, has not yet been introduced into national law. The stability programme states the intention of the government to set up a fiscal council, but no concrete plans are laid out.

Recommendation

- Specify and implement the measures needed to achieve the annual structural adjustment effort set out in the Council recommendations under the

EDP in order to correct the excessive deficit by 2014 in a sustainable and growth-friendly manner, limiting recourse to one-off/temporary measures. After correcting the excessive deficit, pursue the structural adjustment effort at an appropriate pace so as to reach the MTO by 2019. Put in place a binding, rule-based multiannual fiscal framework in 2013. Ensure concrete delivery of measures taken to increase tax compliance and fight tax evasion, and take action to reduce the debt bias in corporate taxation.

- To ensure the long-term sustainability of public finances, continue to reform the pension system to curb the projected increase in expenditure, including by measures such as accelerating the increase in the statutory retirement age, increasing the effective retirement age by aligning retirement age or pension benefits to changes in life expectancy and by encouraging private pension savings. Take measures to increase the employment rate of older workers by finalising and implementing a comprehensive active ageing strategy. Pursue health-care reforms to increase the cost-effectiveness of the sector, in particular by strengthening public primary care provision. Improve the efficiency and reduce the length of public procurement procedures.

20. NL

Summary assessment

The Council is of the opinion that the Netherlands implemented sizeable consolidation measures over 2011-2013, but that the fiscal effort is likely not to be sufficient to correct the excessive deficit by 2013, mainly in light of worse than expected economic developments. The macroeconomic scenario underpinning the budgetary projections in the programme is broadly plausible. For 2013 and 2014, the Stability Programme projects real economic growth of -0.4% and 1.1%, respectively, which is fairly close to the Commission's Spring 2013 forecast of -0.8% and 0.9%. The stated objective of the programme is to reduce the headline deficit to below 3% of GDP from 2014 in a sustainable manner. The programme does not contain an explicit reference to the medium-term objective (MTO), suggesting that the MTO of -0.5%, as communicated in last year's Stability

Programme, is confirmed. The MTO is in line with the requirements of the Stability and Growth Pact. In addition, whilst in 2015 the programme plans a reduction in the structural balance of 0.5% of GDP in structural terms, in line with the minimum annual structural requirement, in 2016 the structural balance is expected to deteriorate by 0.4% of GDP and to improve by 0.1% of GDP in 2017, thereby falling short from the appropriate adjustment path. Based on the Commission Spring forecast, the average annual fiscal effort of around 0.7% of GDP over the period 2010-2013 is in line with the structural effort of ¾% of GDP recommended by the Council. The budgetary adjustment in 2011 and 2012 was predominantly geared to the expenditure side, yet in 2013 relied largely on revenue measures. The planned headline deficit set by the Stability Programme is consistent with a correction of the excessive deficit by 2014, one year after the deadline set by the Council under the excessive deficit procedure in late 2009. The Council considers that the fiscal effort envisaged by the authorities is not compatible with an actual correction of the excessive deficit by 2014. Possible additional consolidation measures specified in the Stability Programme have been temporarily withdrawn and at any rate would not be sufficient. The Netherlands needs to define additional measures to bring the headline general government deficit below the 3% of GDP threshold in 2014 in a sustainable manner. According to the 2013 Stability Programme, the debt-to-GDP ratio is expected to rise further in 2013, to 74% of GDP and to increase slightly further to 75% of GDP in 2014. The debt ratio is thus projected to remain well above the 60% reference value. For 2015, the programme expects the debt ratio to decline to 71.4% of GDP and to decline slightly thereafter, reaching 70.8% in 2017. This decline in the debt ratio after 2014, however, is insufficiently underpinned by policy measures.

Recommendation

- Reinforce and implement the budgetary strategy, supported by sufficiently specified measures, for the year 2014 and beyond to ensure a timely correction of the excessive deficit by 2014 in a sustainable manner and achieve the structural adjustment effort specified in the Council recommendations under the EDP. Protect

expenditure in areas directly relevant for growth such as education, innovation and research. After the correction of the excessive deficit, pursue the structural adjustment effort that will enable the Netherlands reaching the medium-term objective by 2015.

- Adjust the second pension pillar, in consultation with social partners, to ensure an appropriate intra- and inter-generational division of costs and risks. Underpin the gradual increase of the statutory retirement age with measures to increase the employability of older workers. Implement the planned reform of the long-term care system to ensure its cost-effectiveness and complement it with further measures to contain the increase in costs, with a view to ensure sustainability.

21. PL

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is optimistic. In particular, private consumption and private investment is expected to increase more strongly than in the Commission 2013 spring forecast, leading to an overall higher growth rate in 2013 (1.5% against 1.1%). The objective of the budgetary strategy outlined in the programme is to bring the deficit to 3.5% of GDP by 2013 (one year after the original 2012 EDP deadline) and reach the medium-term budgetary objective (MTO) by 2016. However, the 2013 Convergence Programme plans to bring the headline deficit below 3% of GDP only by 2015. Given the overly optimistic growth forecast and revenue projections in the programme the Council considers that the fiscal effort envisaged by the authorities is not compatible with an actual correction of the excessive deficit by 2013 unless significant additional measures are taken to reinforce the effort for this year. The programme is based on an optimistic scenario and not sufficiently supported by detailed measures in order to credibly ensure the correction of the deficit at the latest by 2014. Additional efforts are therefore required based on detailed measures for both 2013 and 2014. The authorities have not sufficiently exploited the pre-crisis growth environment to reform the structure

of public spending to prioritise growth-enhancing items. The programme confirms the previous MTO of -1% of GDP, which reflects the objectives of the Pact. Based on the (recalculated) structural deficit, the MTO is not projected to be attained by 2016, as planned in the programme, as the planned annual progress towards the MTO of 0.3% of GDP (in structural terms) in 2015 and 0.7% of GDP in 2016 is not sufficient. The growth rate of government expenditure, taking into account discretionary revenue measures, is in line with the benchmark of the Stability and Growth Pact over the entire programme period. Additional efforts as well as changes in the composition of the adjustment may be required also in the outer years of the programme as the progress towards the MTO predominantly relies on sizeable cuts in public investment expenditure and is not sufficiently supported by detailed measures. General government debt is projected to remain below 60% of GDP in Poland over the programme period. The national authorities forecast it to remain broadly constant at slightly above 55.5% of GDP until 2014/2015 (and decrease in 2016), whereas the Commission, taking account of possible risks to the consolidation plans and debt decreasing items, expects an increase to around 59% of GDP in 2014. Tax compliance remains a key issue in terms of combating tax evasion, which also requires reducing the administrative burden on taxpayers and improving the efficiency of tax administration. To ensure the success of the fiscal consolidation strategy, it is important that the fiscal consolidation is backed by comprehensive structural reforms.

Recommendation

- Reinforce and implement the budgetary strategy for the year 2013 and beyond, supported by sufficiently specified measures for both 2013 and 2014, to ensure a timely correction of the excessive deficit by 2014 in a sustainable manner and the achievement of the fiscal effort specified in the Council recommendations under the EDP. A durable correction of the fiscal imbalances requires credible implementation of ambitious structural reforms, which would increase the adjustment capacity and boost potential growth and employment. After the correction of the excessive deficit, pursue the structural adjustment effort that

will enable Poland reaching the medium term objective by 2016. With a view to improving the quality of public finances minimise cuts in growth-enhancing investment, reassess expenditure policies improving the targeting of social policies and increasing the cost effectiveness and efficiency of spending in the healthcare sector. Improve tax compliance, in particular by increasing the efficiency of the tax administration.

- Ensure the enactment of a permanent expenditure rule in 2013 consistent with the rules of the European System of Accounts. Take measures to strengthen annual and medium-term budgetary coordination mechanisms among different levels of government.

22. PT

Detailed Recommendations are set out in the Memorandum of Understanding

23. RO

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible and in line with the assessment in the latest European Commission forecast. Thanks to substantial consolidation efforts and in line with the Council recommendation, Romania reduced its general government deficit to below 3% in 2012. The convergence programme aims at an MTO of -1% of GDP (previously -0.7% of GDP), which is in line with the requirements of the Stability and Growth Pact. The objective of the budgetary strategy outlined in the programme is to reach the MTO by 2014 which, when recalculated by Commission based on the commonly agreed methodology, corresponds to reaching the MTO by 2015. The progress in structural terms towards the MTO is higher than 0.5% of GDP in 2013 and about 0.4% in 2014. The expenditure benchmark over the programme period was met. Adjustment is front-loaded in 2013 with revenue-enhancing measures including reductions in tax-deductible items, improvement in the taxation of agriculture, the introduction of a windfall levy following the deregulation of gas prices and introduction of a

special tax on transmission of electricity and gas. The main risks to the convergence programme relate to further possible financial corrections linked to the absorption of EU funds, or the financing from the national budget of priority projects, renewed accumulation of arrears, especially at local government level, and limited progress with restructuring of state-owned enterprises. Romania's public debt remains relatively low, at 37.8% of GDP in 2012. It is expected to rise to 38.6% in 2014 but will remain well below the 60% of GDP threshold over the programme period.

Recommendation

- Complete the EU/IMF financial assistance programme.

- Ensure growth-friendly fiscal consolidation and implement the budgetary strategy for the year 2013 and beyond as envisaged, thus ensuring achievement of the medium term objective by 2015. Improve tax collection by implementing a comprehensive tax compliance strategy and fight undeclared work. In parallel, explore ways to increase reliance on environmental taxes. Continue the pension reform started in 2010 by equalising the pensionable age for men and women and by promoting the employability of older workers.

- Pursue health sector reforms to increase its efficiency, quality and accessibility, in particular for disadvantaged people and remote and isolated communities. Reduce the excessive use of hospital care including by strengthening outpatient care.

- Strengthen governance and the quality of institutions and the public administration, in particular by improving the capacity for strategic and budgetary planning, by increasing the professionalism of the public service through improved human resource management and by strengthening the mechanisms for coordination between the different levels of government. Significantly improve the quality of regulations through the use of impact assessments, and systematic evaluations. Step up efforts to accelerate the absorption of EU funds in particular by strengthening management and control systems and improving public procurement.

24. SE

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible for 2013. The government projects a GDP growth of 1.2% and 2.2% in 2013 and 2014, respectively, whereas the Commission forecasts 1.5% and 2.5%. The objective of the budgetary strategy outlined in the programme is to ensure long-term sustainability of public finances by respecting the rules of the Swedish fiscal framework, including the target of having a surplus in general government net lending of 1% of GDP on average over the business cycle. General government balance slipped from a small surplus of 0.2% of GDP in 2011 to a deficit of 0.5% in 2012. The programme confirms the previous medium-term budgetary objective (MTO) of -1.0% of GDP. The MTO is in line with the requirements of the Stability and Growth Pact. The programme foresees a structural general government balance, as recalculated by the Commission, to improve from a minor deficit around 0.4% of GDP in 2012-13 to a surplus in 2014 and onwards. Therefore, the MTO is likely to be met over the programme period. According to the information in the programme, the growth rate of government expenditure, net of discretionary revenue measures, would exceed the reference medium-term rate of potential GDP growth in 2012 and 2013, but would be below that rate in 2014. Even taking into account the possibility of further expansionary discretionary measures in 2014, the risks to the budgetary targets are limited. According to the programme, the debt ratio, which is below the 60% of GDP reference value, is projected to increase temporarily to 42% of GDP in 2013, but fall back below 40% of GDP in 2015. The Commission forecasts the debt ratio to decline to 39% in 2014.

Recommendation

- Implement the measures necessary to pursue a growth-friendly fiscal policy and preserve a sound fiscal position ensuring compliance with the medium-term objective over the programme horizon.

25. SI

Summary assessment

The Council is of the opinion that despite considerable although back-loaded consolidation efforts that have brought the deficit down from 6.2% of GDP in 2009 to 4.0% of GDP in 2012, Slovenia is not expected to correct its excessive deficit by 2013 as recommended by the Council in late 2009. This is notably linked to a worse economic environment than expected at the time. The macroeconomic scenario underpinning the budgetary projections in the programme is broadly plausible for 2013, but optimistic for 2014. In particular, the authorities anticipate that after a fall in GDP by 2.3% in 2012 and 1.9% in 2013, GDP will grow by 0.2% in 2014, while assuming that fiscal measures are taken to reduce the general government deficit from 4.2% of GDP (excluding bank recapitalisations) in 2013 to 2.6% of GDP in 2014. However, the Commission forecasts that GDP will fall by 0.1% in 2014 based on a no-policy-change assumption, a scenario which only takes into account measures that were adopted by mid-April 2013, and forecasts a deficit of 4.9% of GDP for 2014. The main objectives of the budgetary strategy outlined in the programme are to correct the excessive deficit by 2014, one year after the deadline set by the Council in late 2009, to achieve a balanced structural position by 2017 and stabilise the debt ratio below 55% of GDP. The programme confirms the medium-term objective (MTO), which is a balanced budget in structural terms. This MTO is not in line with the requirements of the Stability and Growth Pact because it does not adequately take into account the implicit liabilities related to ageing. The planned headline deficit targets in the programme are consistent with a correction of the excessive deficit by 2014. However, given the optimistic growth forecast for that year, significant risks to revenue projections as well as insufficiently specified expenditure measures, the Council considers that it is not likely that the excessive deficit will be corrected by 2014. In these circumstances, additional structural consolidation measures should be specified, adopted and implemented to ensure that the excessive deficit is corrected by 2015, at the latest in a credible and sustainable manner as recommended by the

Council on 21 June 2013. The general government debt-to-GDP ratio more than doubled from 22.0% in 2008 to 54.1% in 2012 and is projected to increase further to 66.5% by 2014 according to the Commission's 2013 Spring Forecast. The authorities expect the debt-to-GDP ratio to peak at 63.2% in 2014 and 2015 and then drop to 62.8% in 2016. Risks to the debt-to-GDP ratio are tilted towards a higher ratio, also due to large contingent liabilities and likely stock-flow adjustments from asset transfers to the Bank Asset Management Company, which is not included in programme projections.

In May 2013, the authorities made important steps towards the consolidation of public finances. They achieved an agreement with social partners on an additional 1¼% reduction in basic gross wages in the public sector, on top of the 3% reduction that was agreed in the May 2012 Act on Balancing Public Finances. Furthermore, Parliament approved a constitutional basis for establishing a general government budget balance/surplus rule in structural terms. However, the complete transposition of the provisions of the Fiscal Compact will be made in a special constitutional implementation act, scheduled for parliamentary approval by November 2013. Finally, Parliament almost unanimously tightened the constitutional rules to call and win a referendum, which is expected to facilitate the introduction of fiscal consolidation measures. Given the rapidly increasing debt, it is all the more important that the 2013 budget strategy is reinforced and strictly implemented, and that substantial consolidation efforts are firmly pursued in subsequent years. While some taxes are below the EU average, reliance on tax increases cannot indefinitely postpone the need to tackle expenditure dynamics. It therefore seems appropriate to complement the revenue increasing measures with additional fiscal efforts through structural expenditure cuts. The medium-term budgetary framework and expenditure rule remain insufficiently focused on achieving the MTO and securing long-term sustainability. In addition, budget constraints on certain general government units, especially indirect budgetary users, do not appear to be fully enforced. Finally, international and domestic estimates suggest that the size of the shadow economy in Slovenia is above the EU average,

which indicates room for improving tax compliance as also recognised by envisaged measures in the Stability Programme.

Recommendation

- For the year 2013 and beyond, implement and reinforce the budgetary strategy, supported by sufficiently specified structural measures, to ensure the correction of the excessive deficit by 2015 in a sustainable manner and the improvement of the structural balance specified in the Council recommendation under the EDP. After the correction of the excessive deficit, pursue a structural adjustment effort that will enable Slovenia to reach the MTO by 2017 which should be set in line with the Stability and Growth Pact. Durable correction of the fiscal imbalances requires the implementation of ambitious structural reforms, which would increase the adjustment capacity of the economy and boost potential growth and employment. Safeguard growth-friendly spending, adopt measures to improve tax compliance and implement measures on the expenditure side underpinned by systematic reviews of public expenditure at all government levels. To improve the credibility of consolidation, complete the adoption of a general government budget balance/surplus rule in structural terms, make the medium-term budgetary framework binding, encompassing and transparent, and strengthen the role of independent bodies monitoring fiscal policy by end 2013. Take measures to gradually reduce the contingent liabilities of the state.
- Strengthen the long-term sustainability of the pension system beyond 2020 by further adjusting all relevant parameters, including through linking the statutory retirement age to gains in life expectancy, while preserving the adequacy of pensions. Contain age-related expenditure on long-term care and improve access to services by refocusing care provision from institutional to home care, sharpening targeting of benefits, and reinforcing prevention to reduce disability/dependency.

26. SK

Summary assessment

The Council is of the opinion that Slovakia has reduced the general government deficit from 7.7% of GDP in 2010 to 4.3% of GDP in 2012 thanks to a substantial consolidation effort and, based on current expectations, is on track to correct the excessive deficit. The macroeconomic scenario underpinning the budgetary projections in the programme is plausible. Compared to the Commission forecasts, the authorities assume similar growth rates of GDP with a slightly different composition. The objective of the budgetary strategy outlined in the programme is to achieve a fiscal position that ensures long-term sustainability of public finances. To achieve this, the government confirms the objective of reducing the headline deficit below the 3% of GDP reference value in 2013, in line with the Council recommendation under the Excessive Deficit Procedure. The average annual fiscal effort in 2010-2013 amounts to 1.4% of GDP, well above the required effort of 1% of GDP recommended by the Council. A large part of the expenditure savings in 2013 is expected from the local governments and other general government units over which the central government does not have a direct influence. Achieving the target may therefore be at risk, also in light of expenditure overruns recorded in the past. The programme confirms the previous MTO of -0.5% to be achieved by 2018. The MTO is in line with the requirements of the Stability and Growth Pact. For the years following the expected date of correction of the excessive deficit the projected improvement in the (recalculated) structural budget balance is appropriate in 2014 and 2015 (0.6 pps and 0.7 pps of GDP respectively) but it would be insufficient in 2016 (0.3 pps of GDP). Slovakia is expected to comply with the expenditure benchmark. According to the programme, the government debt is foreseen to remain below the 60% of GDP reference value in the Treaty until 2016. The Commission's spring forecast projects an increase in the debt ratio to 54.6% of GDP in 2013 and 56.7% of GDP in 2014.

In order to ensure the sizeable reduction in the headline deficit since 2011, the authorities have

also relied on reductions in investment financed from the general government budget, which may not be sustainable or desirable in a medium to long run perspective, as well as on one-off measures. Looking forward, the on-going consolidation and convergence process will need to safeguard expenditure on growth enhancing categories, such as education, innovation and transport infrastructure.

Recommendation

- Implement as envisaged the budget for the year 2013, so as to correct the excessive deficit in a sustainable manner and achieve the fiscal effort specified in the Council recommendations under EDP. After the correction of the excessive deficit, pursue the structural adjustment effort that will enable Slovakia to reach the medium-term objective by 2017. Avoid cuts in growth enhancing expenditure and step up efforts to improve the efficiency of public spending. Building on the pension reform already adopted, further improve the long term sustainability of public finance by reducing the financing gap in the public pension system and increasing the cost-effectiveness of the health-care sector.

27. UK

Summary assessment

The Council is of the opinion that the macroeconomic scenario underpinning the budgetary projections in the programme is plausible. The objective of the budgetary strategy outlined in the Convergence Programme is to achieve a cyclically-adjusted budget of close to balance at the end of a five-year rolling period. The general government deficit peaked at 11.5% of GDP in 2009-10 (4) and was reduced to 5.6% of GDP in 2012-13, thanks to one-off measures that artificially reduced the deficit by 2 pp. in 2012-13. However, the Convergence Programme shows that the government is projected to miss the deadline of 2014-15 for correction of the excessive deficit set by the Council as the deficit is estimated at 6.0% of GDP that year. According to programme projections, the year in which the excessive deficit will be corrected is in 2017-18 at 2.3% of GDP, three years after the deadline set by the Council in

December 2009. The programme implies that the structural general government deficit, as recalculated by the Commission, improving marginally from 5.6% of GDP in 2013-14 to 5.1% of GDP in 2014-15. Over the period 2010-11 to 2012-13, the average adjusted fiscal effort is estimated at 1.0% of GDP, well below the 1¾% of GDP recommended by the Council. The main risks to the budgetary projections stem from lower-than-expected growth due to persistently high inflation curtailing private consumption and a potential deterioration in the international environment that could affect trade and investment. The Convergence Programme does not include a medium-term budgetary objective as foreseen by the Stability and Growth Pact. The government has continued with its fiscal consolidation strategy but, because of higher-than-expected expenditure due to the operation of automatic stabilisers and lower-than-expected tax revenues, the deficit is higher than forecast. Also, the consolidation measures taken so far have not been sufficient in attaining the required fiscal effort to correct the excessive deficit. Moreover, the potential revenue contribution from structural reform, e.g. aiming to increase the efficiency of the tax system through revisions of the VAT rate structure, remains relatively under-exploited. Government debt as a percentage of GDP rose from 56.1% in 2008-09 to 90.7% in 2012-13. According to the programme, the general government debt ratio is projected to increase to 100.8% in 2015-16 and 2016-17 before falling back 99.4% in 2017-18.

through a balanced approach to the composition of consolidation measures and promoting medium and long-term fiscal sustainability. In order to raise revenue, make greater use of the standard rate of VAT. Take further action to increase housing supply, including through further liberalisation of spatial planning laws and an efficient operation of the planning system. Ensure that housing policy, including the “Help to Buy” scheme does not encourage excessive mortgage lending; and lead to higher house prices. Pursue reforms to land and property taxation to reduce distortions and promote timely residential construction. Take steps to improve the legal framework of rental markets, in particular by making longer rental terms more attractive to both tenants and landlords.

Recommendation

- Implement a reinforced budgetary strategy, supported by sufficiently specified measures, for the year 2013-14 and beyond. Ensure the correction of the excessive deficit in a sustainable manner by 2014/15, and the achievement of the fiscal effort specified in the Council recommendations under the EDP and set the high public debt ratio on a sustained downward path. A durable correction of the fiscal imbalances requires the credible implementation of ambitious structural reforms which would increase the adjustment capacity and boost potential growth. Pursue a differentiated, growth-friendly approach to fiscal tightening, including through prioritising timely capital expenditure with high economic returns and