EUROPEAN COMMISSION

MEMO

Brussels, 29 May 2013

Commission takes steps under the Excessive Deficit Procedure

Which decisions has the Commission taken today as regards the Excessive Deficit Procedure?

The Commission has today recommended that the Council abrogate the Excessive Deficit Procedure (EDP) for five countries: Italy, Latvia, Hungary, Lithuania and Romania.

The Commission has also recommended that the Council open an EDP for Malta.

Moreover, the Commission has adopted Recommendations to the Council with a view to extend the deadlines for correcting the excessive deficit in six countries: Spain, France, the Netherlands, Poland, Portugal and Slovenia.

In addition, the Commission has recommended that the Council decides that no effective action has been taken by Belgium to put an end to the excessive deficit and that the Council gives notice to Belgium to take measures to correct the excessive deficit.

Abrogation/Opening of an Excessive Deficit Procedure

How many Member States are currently under an Excessive Deficit Procedure?

At the moment there is an Excessive Deficit Procedure (EDP) ongoing for 20 EU Member States. This means all EU Member States except Bulgaria, Germany, Estonia, Luxembourg, Malta, Finland and Sweden are subject to an EDP. Today the Commission has proposed to abrogate the EDP for Italy, Latvia, Hungary, Lithuania and Romania. But the Commission has also proposed to open an EDP for Malta. So if the Council follows the Commission's Recommendations, the overall number of countries in EDP will drop to 16.

What is needed for an Excessive Deficit Procedure to be abrogated?

A decision on the abrogation of an Excessive Deficit Procedure (EDP) is based on a "durable correction" of the excessive deficit. This is deemed achieved if:

- (i) the notified data for the previous year (2012 in these cases) show a deficit below 3% of GDP; and
- (ii) the Commission services' forecast indicates that the deficit will not exceed the 3% of GDP reference value over the forecast horizon (currently 2013 and 2014)

In cases where the deficit remains close to the reference value and the debt level remains below 60% of GDP, the Commission will also take into account the net cost of the implementation of pension reforms involving the setup of a mandatory, fully funded second pillar. In particular, the Commission will take into account if the excess over the 3% threshold is fully explained by the net cost of the implementation of the pension reform.

Why does the Commission recommend that the Council abrogate the EDP for Italy, Latvia, Hungary, Lithuania and Romania?

Italy

The EDP for Italy was launched in 2009. After peaking at 5.5% of GDP in 2009, Italy's general government deficit was steadily brought down and reached 3.0% of GDP in 2012, which was the deadline set by the Council. The Stability Programme for 2013-17, adopted by the Italian government on 10 April 2013 and endorsed by parliament on 7 May, plans for the deficit to decline slightly to 2.9% of GDP in 2013 and then to fall to 1.8% of GDP in 2014. Based on the no-policy-change assumption, the Commission services' 2013 Spring Forecast projects a deficit of 2.9% of GDP in 2013 and 2.5% of GDP in 2014, which is below the Treaty reference value of 3% of GDP.

Latvia

The EDP for Latvia was launched in 2009. Following high general government deficits in 2009 and 2010 (respectively at 9.8% and 8.1% of GDP), which partly reflected measures to stabilise the financial sector, the deficit started rapidly declining in 2011, when it reached 3.6% of GDP. In 2012, the deficit declined further to 1.2% of GDP, thus well below the 3% of GDP Treaty reference value. The Commission services' 2013 Spring Forecast projects that the general government deficit will remain broadly unchanged in 2013 at 1.2% of GDP and will decrease to 0.9% of GDP in 2014 based on the no-policy-change assumption, thus staying well below the reference value of 3% of GDP.

Lithuania

The EDP for Lithuania was launched in 2009. Having peaked at 9.4% of GDP in 2009, the general government deficit in Lithuania was brought down to 7.2% of GDP in 2010, then to 5.5% of GDP in 2011 and to 3.2% of GDP in 2012. Since the deficit of 3.2% of GDP can be considered to be close to the reference value of 3% of GDP and Lithuania's debt-to-GDP ratio is below the 60% of GDP reference value in a sustained manner, Lithuania is eligible for the Stability and Growth Pact provisions allowing for the direct net cost of a systemic pension reform to be taken into account when assessing the correction of the excessive deficit. As the net costs of Lithuania's systemic pension reform were 0.2% of GDP in 2012, they explain the excess over the 3% of GDP Treaty reference value in that year. The Commission services’ 2013 Spring Forecast projects an improvement of the general government deficit to 2.9% of GDP in 2013 and to 2.4% of GDP in 2014 – based on the no-policy-change assumption. As such, the deficit is set to remain below the reference value of 3% of GDP over the forecast horizon.

Hungary

The EDP for Hungary was launched in 2004. In 2012, on the basis of a considerable fiscal effort, the general government deficit reached 1.9% of GDP. This was also thanks to one-off revenues amounting to ¾% of GDP. The Hungarian 2013 Convergence Programme projects that the general government deficit will stay at 2.7% of GDP in both 2013 and 2014. However, the Commission services' 2013 Spring Forecast foresees a deficit of 3.0% of GDP in 2013 and 3.3% of GDP in 2014, which suggests that the excessive deficit has not been brought to an end in a durable way. On 13 May 2013, following the release of the Spring Forecast, the Hungarian government adopted further corrective measures amounting in gross terms to about 0.3% and 0.7% of GDP for 2013 and 2014, respectively. The Commission's updated fiscal assessment, which takes into account the impact of these additional corrective measures, projects a deficit of 2.7% and 2.9% in 2013 and 2014, respectively. Thus, the deficit is expected to remain below the Treaty reference value of 3% of GDP over the forecast horizon.

Romania

The EDP for Romania was launched in 2009. The larger-than-expected recession in 2009 resulted in a significant shortfall in government revenue, which pushed the general government deficit to 9% of GDP despite efforts to reduce government expenditure. The deficit was subsequently reduced to 6.8% of GDP in 2010, to 5.6% of GDP in 2011 and to 2.9% of GDP in 2012, which is below the 3% of GDP Treaty reference value. In the Commission services' 2013 Spring Forecast, the general government deficit is projected to decrease to 2.6% of GDP in 2013 and to 2.4% of GDP in 2014 – based on the no-policy-change assumption – thus remaining below the Treaty reference value of 3% of GDP.

Why is the Commission recommending that the Council open an EDP for Malta?

Since accession to the EU, Malta has been subject to two Excessive Deficit Procedures (EDP). The first was launched in July 2004 and was abrogated in June 2007. The second was launched in July 2009 and abrogated in December 2012. According to data notified by the Maltese authorities in April 2013, the general government deficit in Malta reached 3.3% of GDP in 2012, thus exceeding the 3%-of-GDP reference value of the Treaty. The Commission report under Article 126(3), which represents the first step in the EDP, considers that the deficit was close to the 3%-of-GDP reference value, but the excess over the reference value could not be qualified as exceptional nor temporary within the meaning of the Treaty and the Stability and Growth Pact. The Commission services' 2013 Spring Forecast projects that the deficit will continue to be above the reference value in 2013 and 2014, respectively at 3.7% and 3.6% of GDP. In addition, in 2012 the debt ratio was above the 60%-of-GDP reference value and Malta did not make sufficient progress towards compliance with the debt reduction benchmark, in line with the requirements of the transition period[1]. In light of the above the Commission recommends that the Council decides on the existence of an excessive deficit in accordance with Article 126(6) of the Treaty.

When should Malta correct its excessive deficit?

The Commission recommends that the Council should address recommendations to Malta under Article 126(7)in order to put an end to the present excessive deficit situation by **2014**. Specifically, Malta should reach a headline deficit target of 3.4% of GDP for 2013 and 2.7% of GDP in 2014, which is consistent with an annual improvement of the structural balance of 0.7% of GDP in 2013, and 0.7% of GDP in 2014. This adjustment path would allow bringing the deficit below the 3% of GDP reference value by 2014 while at the same time ensuring that the debt ratio will approach the 60%-of-GDP reference value at a satisfactory pace.

[1] Under the Six-Pack legislation which entered into force in December 2011, upon exiting an existing EDP, a Member State enters a three-year transition period before the full application of the debt criterion, during which it must nonetheless make sufficient progress towards complying with the debt benchmark. A negative assessment of the progress made towards compliance should lead to the preparation of a report by the Commission, based on Article 126(3), and can lead to the opening of a new EDP. For Malta, the transition period to comply with the debt reduction benchmark started in 2012. The Commission's assessment is that the structural effort implemented by Malta in 2012 was not sufficient to meet the requirements of the transition period..

Extensions of the deadline for correcting the excessive deficit

Which countries are concerned? What is the new fiscal adjustment path?

Spain

The Commission recommends **extending the deadline for Spain by two years**, so that the country should put an end to the present excessive deficit situation by **2016**. Spain should deliver an improvement of the structural budget balance of 1.1% of GDP in 2013, 0.8% of GDP in 2014, 0.8% of GDP in 2015, and 1.2% of GDP in 2016, in order to bring the headline government deficit below the 3% of GDP reference value by 2016, based on the Commission services' 2013 Spring Forecast. The corresponding headline deficit targets should be 6.5% of GDP for 2013, 5.8% of GDP for 2014, 4.2% of GDP for 2015, and 2.8% of GDP for 2016.

France

The Commission recommends to **extend the deadline for France by two years** so that France should put an end to the present excessive deficit situation by 2015 at the latest. France should reach a headline deficit of 3.9% of GDP in 2013, 3.6% in 2014 and 2.8% in 2015, which is consistent with delivering an improvement in the structural balance of 1.3% of GDP in 2013, 0.8% in 2014 and 0.8% in 2015, based on the Commission services' 2013 Spring Forecast (extended to 2015).

Netherlands

The Commission recommends **extending the deadline for the Netherlands by one year** so that the country should put an end to the present excessive deficit situation by **2014** at the latest. The Netherlands should reach a headline deficit target of 3.6% in 2013 and 2.8% of GDP in 2014, which is consistent with an improvement of the structural balance of around 0.6% of GDP in 2013 and 0.7% of GDP in 2014.

Poland

The Commission recommends **extending the deadline for Poland by two years**, so that Poland should bring an end to the excessive deficit situation by **2014** at the latest. Poland should reach a headline deficit target of 3.6% and 3.0% of GDP in 2013 and 2014, wich is consitent with an annual improvement of the structural balance of at least 0.8% and 1.3% of GDP respectively, based on the updated Commission services' 2013 Spring Forecast.

Portugal

The Commission recommends **extending the deadline for Portugal by one year**, so that the country should bring an end to the present excessive deficit situation by **2015**. The Portuguese authorities should bring the headline deficit targets to 5.5% of GDP in 2013, 4.0% of GDP in 2014 and 2.5% of GDP in 2015, which is consistent with an improvement in the structural balance of 0.6% of GDP in 2013, 1.4% of GDP in 2014 and 0.5% of GDP in 2015, based on the Commission services' May 2013 update of the economic outlook for Portugal.

Slovenia

The Commission recommends **extending the deadline for Slovenia by two years**, so that the country should bring an end to the present excessive deficit situation by **2015**. Slovenia should reach a headline general government deficit target of 4.9% of GDP in 2013 (3.7% of GDP excluding 1.2% of GDP one-off expenditure to recapitalise the two largest banks), 3.3% of GDP in 2014 and 2.5% of GDP in 2015. This is consistent with an annual improvement of the structural balance of 0.75% of GDP in 2013, 0.5% of GDP in 2014 and 0.5% of GDP in 2015, in order to bring the headline government deficit below the 3% of GDP threshold by 2015, based on the Commission services' updated 2013 Spring Forecast.

What are the conditions for being granted additional time to correct the excessive deficit?

Additional time can be granted to a Member State to correct an excessive deficit, without stepping up the EDP, provided two conditions are met:

- There must have been an unexpected economic event with major unfavourable consequences for the Member State concerned by the EDP, meaning that the deadline for correcting the excessive deficit can no longer be met.
- The Member State has to have taken "effective action" to comply with the recommendation or notice addressed to it by the Council.

A Member State is considered to have taken effective action if it has acted in compliance with the Council recommendation, regarding both the implementation of the measures required and the budgetary execution. In case the nominal targets are not met, a careful analysis of the structural effort delivered (measured by the change in structural balance, i.e. the budget balance net of the effect of the economic cycle and the impact of one-off and temporary measures) is carried out in order to determine whether the Member State has adopted measures of the magnitude required.

When a Member State has taken effective action but cannot meet the deadline due to unexpected events with major negative consequences for government finances, the Council may decide to adopt a revised recommendation, extending the deadline for the correction of the excessive deficit.

What is the legal basis for the extension?

The legal basis is Article 3(5) of Regulation 1467/97. It says that the Council may decide, on a recommendation from the Commission, to adopt a revised recommendation under Article 126(7) of the Treaty on the Functioning of the European Union, if effective action has been taken and unexpected adverse economic events with major unfavourable consequences for government finances have occurred.

What are the next steps?

The Commission recommends that the Council establish 1 October 2013 as the deadline for Spain, France, the Netherlands, Poland and Slovenia to take effective action (i.e. to publicly announce or take measures that seem sufficient to ensure adequate progress towards the correction of the excessive deficit) and to report in detail the consolidation strategy that is envisaged to achieve their respective targets. For Portugal the conditions of the economic adjustment programme apply.

What happens if the countries do not take effective action?

Following the deadline for taking effective action, the Commission will make an assessment of action taken and communicate its findings to the Council. In case the assessment is negative, the Commission will recommend that the Council decide that no action has been taken (Art. 126(8) of the Treaty). In that case, for euro area Member States, the Commission will also recommend the Council to step up the EDP, i.e. to give notice to the Member State concerned (Art. 126(9) of the Treaty).

Stepping up the EDP for Belgium

What is the Commission recommending for Belgium?

The Commission recommends that the Council decides under Article 126(8) that Belgium has not taken effective action in response to the Council Recommendation under Article 126(7) of 2 December 2009 and to decide under Article 126(9) to give notice to Belgium to take measures to correct the excessive deficit by 2013.

Why does the Commission conclude that Belgium has not taken effective action?

The Excessive Deficit Procedure (EDP) for Belgium was launched in 2009 and the country was asked to correct its excessive deficit by 2012. But the 2012 deficit came out at 3.9% of GDP. Hence, Belgium did not correct its excessive deficit by the deadline recommended by the Council. This was partly due to the urgent need to recapitalize the banking group Dexia at the end of 2012, which had a negative impact of 0.8% of GDP on the government deficit. However, also without this operation the deadline would have been missed.

The average annual fiscal effort since 2010 is estimated at 0.3% of GDP, significantly below the ¾% of GDP recommended by the Council. Also after correction for the effects of revised potential output growth and revenue developments, the adjusted average fiscal effort is less than half of the recommended effort.

Measures taken in the initial 2013 budget and the March 2013 budget control, are currently expected to bring the deficit below 3% of GDP in 2013. However, according to the Commission services' 2013 Spring Forecast, the safety margin against breaching the Treaty reference value is very narrow. Moreover, the correction is currently not yet sustainable. Therefore, a further reduction of the 2013 deficit to 2.7% of GDP is warranted in order to secure a lasting improvement in the general government balance.

What is the new adjustment path for Belgium?

The Commission recommends that the Council decides that Belgium shall put an end to the present excessive deficit situation by 2013. Belgium shall reduce the headline deficit to 2.7% of GDP in 2013. This nominal improvement is consistent with an improvement in the structural balance of 1% of GDP in 2013, based on the Commission services' 2013 Spring Forecast.

Belgium shall submit to the Commission, by 21 September 2013 at the latest, a report outlining the measures taken to comply with this Decision. The Commission will evaluate this report with a view to assessing progress made towards the correction of the excessive deficit.

General

What is the next step?

Finance Ministers will discuss today's Recommendations at the ECOFIN Council meeting on 21 June in Luxembourg.

What are the main features of the Excessive Deficit Procedure (EDP)?

The Excessive Deficit Procedure (EDP) is a rule-based process established in the Treaty on the Functioning of the European Union (TFEU, Article 126) to ensure that Member States correct gross fiscal policy errors. There are two key reference values, which, when breached, constitute criteria on the basis of which the opening of an EDP can be warranted: one for the general government deficit (3% of GDP) and one for gross government debt (60% of GDP). To ensure the correction of excessive deficits, Member States in EDP are subject to recommendations that are to be respected by a certain deadline.

The various steps within the EDP are listed in the Treaty and specified further in the Stability and Growth Pact (SGP) legislation (Regulation (EC) 1467/97). While the EDP corresponds to the "corrective arm" of the SGP, it is complemented by a "preventive arm" (defined in Regulation (EC) 1466/97), which comprises procedures to promote surveillance and coordination of economic policies and ensure progress towards fiscal sustainability.

The EDP has recently been reinforced as part of the overhaul of the economic governance architecture in the EU, partly in response to the economic crisis. In particular, the legislative package known as the "Six Pack" has largely reformed economic and budgetary surveillance in the EU (MEMO/11/898).

Are euro area programme countries covered by the EDP?

Yes, there is an ongoing Excessive Deficit Procedure (EDP) for Greece, Ireland, Portugal and Cyprus. But there are certain provisions in order to avoid a doubling of monitoring and reporting requirements. The Commission has already implemented this principle, which is confirmed by a Regulation of the Two-Pack that will enter into force on 30 May (MEMO/13/196). In general, the aim of the Two-Pack, which is made up of two regulations, is to further strengthen budgetary surveillance and coordination of economic and budgetary policy in the euro area. Contrary to the EDP, the Macroeconomic Imbalance Procedure does not cover Member States which are subject to an adjustment programme.

For more information see:

http://ec.europa.eu/economy_finance/economic_governance/sgp/corrective_arm/index_en.htm.