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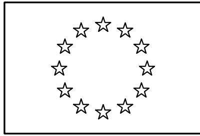

EUROPEAN COMMISSION

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Current state of the excessive deficit procedure in the Member States

and assessment of the action taken by Cyprus, Finland, Bulgaria and Denmark in response to the Council Recommendation of 13 July 2010 with a view to bringing an end to the situation of excessive government deficit

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1. INTRODUCTION AND CONTEXT

The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value set in the Treaty on the Functioning of the European Union (TFEU). The majority of EU Member States currently have general government deficits above the 3% of GDP reference value. The origin of the often strong deterioration in the deficit and the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn in 2008-2009. Recognising the important role of budgetary policies, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan, which was endorsed by the European Council in December 2008.

In October 2009, capitalizing on first signs of recovery, the European Council endorsed an ambitious fiscal exit strategy, which should be coordinated across Member States in the framework of consistent implementation of the Stability and Growth Pact and include a timely withdrawal of the fiscal stimulus. Provided that the Commission forecasts continue to indicate that the recovery is strengthening and becoming self-sustaining, fiscal consolidation in all EU Member States should start in 2011 at the latest. Specificities of country situations should be taken into account, and a number of countries need to consolidate before then. Moreover, the planned pace of the fiscal consolidation should be ambitious, and will have to go well beyond the benchmark of 0.5% of GDP per annum in structural terms in most Member States. Finally, important flanking policies to the fiscal exit will include strengthened national budgetary frameworks for underpinning the credibility of consolidation strategies and measures to support long-term fiscal sustainability, as emphasised by the SGP. In addition, structural reform efforts should be strengthened to enhance productivity and to support long-term investment. The establishment of the European semester of policy coordination and ongoing reform of economic governance in the EU are supporting this consolidation process.

The Commission services' autumn 2010 forecast confirmed that the real economy has shown signs of improvement in some quarters, while uncertainties remain. Periods of renewed confidence in the return to growth alternate with setbacks, also due to the risks associated with the sovereign debt market. European economies face major adjustments. The financial sector has not yet returned to normal conditions and there are situations of vulnerability to stress and dependency on state-support. In this context, the Ecofin Council agreement of 9 May 2010 and the establishment of financial backstops represent important steps to safeguard the stability of the euro area and EU economies.

Against this background, the Commission launched the first European Semester of economic policy coordination with the Annual Growth Survey on 12 January 2011. The European Semester will provide the framework for aligning the timing and assessment of the Stability and Convergence Programmes on macroeconomic outlook and fiscal plans, with the National Reform Programmes on the progress towards the Europe 2020 targets. The Annual Growth Survey focuses on an integrated approach, which encompasses the need for rigorous fiscal consolidation for enhancing economic stability, labour market reforms for higher employment and growth-enhancing measures. Specifically, all Member States, especially those in excessive deficit procedure, should keep public expenditure growth firmly below the rate of medium term trend GDP growth, while prioritising sustainable growth friendly expenditure in areas such as research, education and energy. Moreover, Member States in excessive deficit procedure should set out the expenditure path and the broad measures they intend to take in order to eliminate their excessive deficits. Finally, Member States facing very large structural

budget deficits, very high levels of public debt or high levels of financial distress need to frontload their efforts in 2011. In cases where economic growth or revenues turn out to be higher than expected, fiscal consolidation should be accelerated.

2. CURRENT STATE OF THE EXCESSIVE DEFICIT PROCEDURE IN THE MEMBER STATES

Currently, all Member States except Estonia, Luxembourg and Sweden are in the Excessive Deficit Procedure. Following the positive assessment of action taken by the Member States concerned, the EDP for nineteen Member States is now held in abeyance[1]. Based on currently available information, most are on good path to reduce their deficit in line with the Council's recommendations. However, in spite of the positive current assessment, the Commission considers that a number of risks still exist in some of the Member States concerned.

With respect to the remaining Member States, the Commission has now carried out an assessment of action taken by Cyprus, Finland, Bulgaria and Denmark in line with Art. 9(3) of Regulation (EC) No 1467/97[2] (see Section 3 and the Annex). For Ireland, for which the Council issued its latest recommendations under Art. 126(7) on 7 December, the Commission will make a similar assessment after the deadline of 7 June as foreseen in the latter recommendation.

As required by the Stability and Growth Pact, the Commission continues monitoring the budgetary developments closely and will adopt the necessary recommendations for the Council to take further steps under the EDP at any time when action by a Member State is not being implemented or is proving to be inadequate, according to the Treaty and Regulation (EC) No 1467/97.

The Commission services 2010 autumn forecast projects the general government deficit to decline from 6.8% of GDP in 2010 to 5.1% of GDP in 2011 in the EU and from 6.3% to 4.6% for the euro area. The fiscal effort by Member States, expressed as the improvement in the structural deficit (the deficit net of the cyclical impact and temporary policy measures), is estimated to amount to 1 percentage point of GDP in the EU (1.1 percentage point in the euro area) in 2011. The emphasis on structural (i.e. lasting) measures is important in view of the Council recommendation that Member States should bring the general government deficit below 3 % of GDP in a credible and sustainable manner.

Some Member States (Germany, the Netherlands, Finland, Bulgaria and Malta) are projected to correct the excessive deficit within the forecast period at or even before the respective time limit set by the Council. In most cases, the fiscal effort in 2011 would (significantly) exceed the average annual fiscal effort recommended by the Council in the context of the EDP. In Austria and Denmark, the deficit is projected to come close to the reference value already in 2012, the year before the deadline set by the Council. In Austria, additional measures in December would bring the deficit even closer to the reference value.

In most cases the improvement in the structural balance in 2011 is broadly in line with the recommended fiscal effort, which, given the exceptional circumstances, was usually given in

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[1] For each Member State the assessment of action taken following the 6 month deadline in the recommendations was communicated to the Council. All Commission Communications as well as other documents related to the EDP for each Member State (past and ongoing) are available at: http://ec.europa.eu/economy_finance/sgp/deficit/countries/index_en.htm.

[2] OJ L 209, 2.8.1997, p. 6.

terms of an annual average until the time limit for correction. In 2011 the improvement in the structural balance in Portugal, Spain, France and Romania is projected to be above the required average annual fiscal effort. An improvement in the structural balance in line with the required average annual fiscal effort is foreseen for the UK. Based on current information, the remaining average annual effort needed to correct the excessive deficit by 2012 for Romania, 2013 for Portugal, Spain and France, and by financial year 2014/15 for the UK appears to be within reach.

In Italy and Slovenia, the improvement of the structural balance in both 2010 and 2011 falls somewhat short of the required average annual fiscal effort, and the general government deficit is higher than anticipated in the latest update of the stability programme (in particular in Slovenia). The remaining average annual effort needed to correct the excessive deficit by 2012 for Italy and by 2013 for Slovenia appears limited and within reach. In case of Slovakia, budgetary developments in 2010 turned out much worse than anticipated in the latest stability programme update. However, the 2011 budget contains a significant package of consolidation measures that is forecast to bring the fiscal consolidation back on track. For the Czech Republic the Council recommended for 2010 a target in terms of the general government balance, which the autumn forecast projects to be met, followed by slightly faster decline that foreseen in the last update of the convergence programme, on the back of improved cyclical conditions. Although for 2011 the improvement in the structural balance falls below the required average annual fiscal effort, the additional annual average fiscal effort needed to bring the deficit down to 3% of GDP by the deadline is well within reach.

Following the 2010 autumn forecast, Cyprus and Latvia adopted further measures which will bring the budgetary situation in line with the Council's recommendations. For Lithuania, the forecast does not yet include the impact of a contingency clause in the budget, which will trigger a supplementary budget in case the EDP targets would come at risk. For Belgium (where the budgetary outturn for 2010 was better than expected), the forecast does not yet include the budget for 2011, but in the meantime the authorities have announced their commitment to bring the deficit below 4% in 2011, which is better than foreseen in the latest stability programme update.

To Greece, the Council adopted in May 2010 a revised decision to give notice under Article 126(9) and 136 TFEU, setting 2014 as the deadline for correcting the excessive deficit. Greece should achieve a deficit of 8% of GDP in 2010, 7.6% in 2011, 6.5% in 2012, 4.9% in 2013 and 2.6% in 2014. To this aim, an improvement in the structural balance of at least 10% of GDP will have to be achieved over the period 2009-2014. In its Communication of 9 December, the Commission concluded that Greece is satisfactorily complying with the May Council Decision.

Overall, in view of the autumn 2010 forecast and subsequent information after the forecast publication, the Commission does not consider action taken by any of the Member States mentioned above to correct the excessive deficit proving to be inadequate.

For those Member States, where the fiscal effort in 2011 (and in 2010 where applicable) would lie below the required annual average effort, the additional effort for the remainder of the consolidation period appears well in reach. However, the larger the required budgetary adjustment, the more pressing is the need to avoid any slippage and to frontload the necessary budgetary measures.

In particular the Commission calls on those Member States, where the adjustment effort so far has been below the average annual effort recommended by the Council, to step up their consolidation efforts and, where necessary, underpin their consolidation strategy through the announcement of decisive, concrete and structural measures, in particular in the preparation of the stability and convergence programmes to be submitted to the Council and the Commission in April in the new European Semester.

For Hungary, the autumn forecast projected a deficit of 4.7% of GDP in 2011.However, the one-off impact of the subsequently adopted changes to the pension system could bring the nominal budget deficit below 3% of GDP in 2011. Nevertheless, the structural balance continues to worsen in 2011, which would prompt the budget to rebound into deficit of about 5% of GDP in 2012 if no additional measures are taken. Additional significant consolidation efforts would be needed, starting from 2011, to ensure a sustainable correction of the excessive deficit by 2011, the time limit set by the Council. In Poland, the deficit for 2010 is projected at 7.9%, which is 1.0 pp. higher than foreseen in the 2010 convergence programme, and is lacking structural improvement. Following the 2010 autumn forecast, Poland announced additional measures, which, if adopted, could bring the fiscal effort in 2011 broadly in line with the recommended average annual fiscal effort. Additional significant consolidation efforts would be needed in the period between 2011 and 2012 to bring the general government deficit below 3% of GDP in 2012, the time limit set by the Council. Given the above, Commissioner Rehn has addressed a letter to Hungary and to Poland asking to reconfirm their commitment to fully respect the recommendations by the Council and to soon announce permanent, concrete and specific measures necessary to underpin this commitment.

3. ASSESSMENT OF ACTION TAKEN IN CYPRUS, FINLAND, BULGARIA AND DENMARK

In accordance with Article 9(3) of Council Regulation 1467/97, which states that, following the expiry of the deadline for a Member State to take measures following a recommendation under Art. 126(7) of the Treaty, "*…the Commission shall inform the Council if it considers that the measures taken seem sufficient to ensure adequate progress towards the correction of the excessive deficit within the time limits set by the Council, provided that they are fully implemented and that economic developments are in line with forecasts*", this section (and the Annex to this communication) assesses the action taken by Cyprus, Finland, Bulgaria and Denmark in response to the Council's recommendation of 13 July 2010, with a view to bringing the situation of an excessive deficit to an end. These recommendations were based on the Commission services' spring 2010 forecast and on the agreed principles underlying the fiscal exit strategy. The Council set the date of 13 January 2011 for taking effective action in response to the recommendations.

According to Regulation (EC) No 1467/972 and the revised Code of Conduct[3], a Member State should be considered to have taken effective action if it has acted in compliance with the Article 126(7) TFEU recommendation. The Code of Conduct states that the assessment of effective action should in particular take into account whether the Member State concerned has achieved the annual improvement of its cyclically adjusted balance, net of one-off and

[3] "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 10 November 2009, available at: http://ec.europa.eu/economy_finance/sgp/deficit/legal_texts/index_en.htm.

other temporary measures, initially recommended by the Council. It also stipulates that should the observed adjustment proves to be lower than recommended, a careful analysis of the reasons for shortfall should be made. In case of a multi-annual adjustment, the Code of Conduct specifies that the assessment should mainly focus on the measures taken in order to ensure an adequate fiscal adjustment in the year following the identification of the excessive deficit.

Against this background, the Commission has made an assessment of action taken by Cyprus, Finland, Bulgaria and Denmark, in response to the Council recommendations of 13 July 2010. It appears, on the basis of currently available information, that Cyprus, Finland, Bulgaria and Denmark have taken action representing adequate progress towards the correction of the excessive deficit with the time limits set by the Council. The Commission therefore considers that, for these Member States, no further steps in the excessive deficit procedure are needed at present. Details of this assessment are presented in the country-specific sections in the Annex to this communication.

The Commission will continue to closely monitor budgetary developments in Cyprus, Finland, Bulgaria and Denmark in accordance with the Treaty and the provisions of the Stability and Growth Pact.

ANNEX

1. CYPRUS

1.1. Excessive deficit procedure and most recent recommendations

According to the April 2010 EDP notification, the general government deficit in Cyprus reached 6.1% of GDP in 2009 from a surplus of 0.9% in 2008. This was a result of a severe economic downturn and discretionary measures in response to the economic downturn (in line with the European Economic Recovery Plan (EERP)) but also of rather large composition effects on account of a much less tax-rich GDP growth pattern. In parallel, the general government gross debt stood at 56.2% of GDP, below the 60% of GDP reference value but on a rising trend. Against this background, on 13 July 2010, the Council decided that an excessive deficit existed and addressed recommendations to Cyprus in accordance with Article 126(7) TFEU with a view to bringing an end to the situation of an excessive government deficit by 2012.[4] In its recommendations, the Council established a deadline of 13 January 2011 for effective action to be taken.

In particular, the Council recommended Cyprus to bring the general government deficit below 3 % of GDP in a credible and sustainable manner by taking action in a medium-term framework. Specifically, to this end, Cyprus should: (a) take necessary measures to reduce the 2010 deficit to at most 6% of GDP and define an expenditure-driven consolidation strategy, in order to bring the deficit below the reference value by 2012; (b) to this end ensure an average annual fiscal effort of at least 1½ % of GDP over the period 2011-2012, which should also contribute to bringing the government gross debt ratio back on a declining path that approaches the reference value at a satisfactory pace by restoring an adequate level of the primary surplus; and (c) specify and rigorously implement the measures that are necessary to achieve the correction of the excessive deficit by 2012, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

To limit risks to the adjustment, a strengthening of the binding nature of Cyprus' medium-term budgetary framework and better monitoring of budget execution throughout the year were requested. In addition, the Cypriot authorities were recommended to improve the long-term sustainability of public finances by implementing reform measures to control pension and health care expenditure in order to curb the projected increase in age-related expenditure. Finally, Cyprus was recommended to seize any opportunity beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the 60% of GDP reference value.

The Council established the deadline of 13 January 2011 for Cyprus to take effective action to take necessary measures to reduce the 2010 deficit to at most 6% of GDP and define an expenditure-driven consolidation strategy, in order to bring the deficit below the reference value by 2012, by ensuring an average annual fiscal effort of at least 1½ % of GDP over the period 2011-2012.

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

The Commission makes its assessment of action taken after the adoption by the government of the 2011 budget in tandem with a package of fiscal consolidation measures, on 16 December, and based on the Commission services' autumn 2010 forecast, which incorporated the draft budget.

1.2. Assessment of action taken

The Commission services' autumn 2010 forecasts, on the basis of available information at the time - including the draft budget, estimated that the budget deficit appeared to have stabilised in 2010 at a level similar to the previous year, at 5.9% of GDP, as a marginal increase in revenues is set to have been fully offset by a rise in expenditures. However, recently published cash data of the consolidated accounts of the central government and administered funds for the period January – November 2010 appear to support the estimate for a lower-than-expected budget deficit, as they demonstrate a reduction of the deficit an improvement by 0.5 percentage points over the same period of 2009.

The Commission therefore concludes that the budgetary outcome of 2010 is expected to be in line with the Council recommendation of reducing the 2010 deficit to at most 6% of GDP. Furthermore, as economic conditions are turning out better than expected at the time the Council issued its recommendations, there was a slight acceleration in the reduction of the deficit.

On the basis of the 2011 draft budget available at the time, the Commission services autumn 2010 forecast[5] projected a deficit of 5.7% of GDP for 2011.

For 2011, the Budget Law[6] targets a deficit of 5.4% of GDP, on the basis of an estimated deficit for 2010 of just below 6% of GDP. On the revenue side, the budget does not incorporate any additional measures, apart from the phasing-out of the tax-relief, which was part of the stimulus measures, and the harmonisation of excise duties on petroleum products, in effect since last July. Nevertheless, these are partly offset by a reduction in other current revenues. On the expenditure side, the budget aims at savings through a reduction of operational expenditure, as well as restraint in public investment and employment. However, these elements are fully offset by a rise in the public wage bill, interest payments and in social outlays.

With a view to reducing the budget deficit to 4.5% of GDP in line with last July's Council recommendations to bring an end to the situation of an excessive government deficit (EDP 126.7), the Cypriot authorities adopted a fiscal consolidation package in tandem with the adoption of the Budget. As explained in the letter sent by Minister of Finance Stavrakis to Commissioner Rehn on 7 January 2011, the authorities estimate the consolidation arising from this package at 1 percentage point (pp.) of GDP, out of which 0.6 pp. of GDP are on the revenue side and of permanent nature. In addition, the coalition parties have agreed on an additional set of measures, which will be submitted to the Parliament for approval in February 2011. This is estimated by the authorities to yield an additional 0.6 pp. of GDP of consolidation in 2011, from both revenue supporting and expenditure containing measures.

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[5] The Commission services autumn 2010 forecasts were published on 29 November 2010. The data cut-off date was 15 November 2010.

[6] The 2011 Budget Law was adopted by the Parliament on 16 December 2010.

The Commission services' autumn 2010 forecast does not incorporate the recently adopted package of consolidation measures, as this was not available as at the data cut-off date. This forecast implies an improvement in the structural balance (the cyclically-adjusted balance net of one-off and other temporary measures) by ¾ pp. of GDP in 2011, after a neutral impact in 2010. The adoption of the aforementioned fiscal consolidation package, taken at face value, would improve both the headline and the structural balance by a 1 percentage point of GDP. The adoption of the additional set of pending measures, accounting for 0.6 pp. of GDP is expected to have a similar impact. Overall, the improvement of the headline and the structural balance in 2011 would be around 2¼ pp. of GDP. Benefiting from the base-effect of the lower-than-expected deficit outturn in 2010 (by 0.4 percentage points of GDP), the headline balance would thus be expected to amount to 3¾% of GDP in 2011.

However, there are risks to the achievement of the deficit targets, mainly stemming from the standard practise of adopting supplementary budgets during the course of the year. Slippages in social transfers due to pressure to adopt measures to alleviate the impact of indirect tax rises and the impact of the wage indexation (COLA) on the public wage bill, in case of a higher-than-expected increase in inflation, also pose a considerable risk. Moreover, there are risks for the budgetary impact of announced yet not adopted consolidation measures due to pressures from affected parties.

Against this background, the Commission concludes that Cyprus has ensured a fiscal effort of at least 1½ percentage points of GDP in 2011 and has taken effective action to put an end to the present situation of excessive deficit by 2012. However, the bulk of the fiscal consolidation measures adopted by Cyprus have been on the revenue side despite the Council recommendation for an expenditure-driven consolidation strategy.

In the autumn 2010 forecast, the Commission services estimate Cyprus' gross debt-to-GDP ratio to increase to 65.2% by 2011, on account of a higher primary deficit. The Cypriot authorities project the general government debt to increase to almost 62% of GDP in 2010, from 58% in 2009, mainly due to the negative impact of primary deficit. For 2011, the authorities project a slight rise in the debt ratio, to 63.8%, again due to the primary deficit. However, the adoption of the fiscal consolidation package is expected to stabilise the debt-to-GDP-ratio in 2011 at levels similar to 2010, through the containment of the primary deficit. The continuation of consolidation measures in 2012, coupled with the acceleration of growth, should contribute in reversing debt to a declining trend.

In light of the Commission services' projections and measures taken after the cut-off date of the forecast, Cyprus is expected to bring the general government gross debt ratio back on a declining path within the forecast horizon.

Finally, no progress has been reported in the area of strengthening fiscal governance, such as accelerating the implementation and strengthening the binding nature of Cyprus' three-year medium-term budgetary framework (MTBF). Plans for further reforms to the pension system are still under discussion.

1.3. Conclusions

On the basis of currently available information, it appears that Cyprus has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, it has taken measures to correct the excessive deficit by 2012, while ensuring an adequate fiscal effort in 2011, in line with the Council's recommendations.

However, there are risks to the achievement of the deficit targets, mainly stemming from the standard practise of adopting supplementary budgets during the course of the year, but also due to possible slippages in social transfers and the impact of the wage indexation (COLA) on the public wage bill. In light of these risks, the Cypriot authorities must closely monitor budgetary developments and be ready to take corrective measures should any of these risks materialise.

Furthermore, the Commission is of the opinion that Cyprus needs to be more effective in strengthening the binding nature of its medium-term budgetary framework and introducing measures aimed at addressing the long-term sustainability of Cyprus' public finances, in line with the Council recommendations.

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

Table: Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011
Real GDP (% change)	COM	3.6	-1.7	0.5	1.5
	CY	3.6	-1.7	0.6	1.5
	SP	*3.6*	*-1.7*	*0.5*	*1.5*
Output gap (% of potential GDP)	COM[2]	3.1	-1.2	-2.2	-1.8
	CY	n.a.	n.a.	n.a.	n.a.
	SP[1]	*2.9*	*-1.3*	*-2.4*	*-2.5*
General government balance (% of GDP)	COM	0.9	-6.0	-5.9	-5.7
	CY	0.9	-6.0	-5.9	-5.4
	SP	*0.9*	*-6.1*	*-6.0*	*-4.5*
Primary balance (% of GDP)	COM	3.7	-3.4	-3.6	-3.3
	CY	3.7	-3.4	-3.6	-3.0
	SP	*3.7*	*-3.6*	*-3.7*	*-2.1*
Cyclically-adjusted balance (% of GDP)	COM	-0.3	-5.5	-5.1	-5.0
	CY	n.a.	n.a.	n.a.	n.a.
	SP[1]	*-0.2*	*-5.6*	*-5.1*	*-3.5*
Structural balance[3] (% of GDP)	COM	-0.3	-5.7	-5.7	-5.0
	CY	n.a.	n.a.	n.a.	n.a.
	SP	*-0.2*	*-5.6*	*-5.2*	*-3.6*
Government gross debt (% of GDP)	COM	48.3	58.0	62.2	65.2
	CY	48.3	58.0	61.9	63.8
	SP	*48.4*	*56.2*	*61.0*	*63.2*

Notes:

1 Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

2 Based on estimated potential growth of 2.5%, 1.5%, 1.1% and 1.1% respectively in the period 2009-2012.

3 Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.3% of GDP in 2009 and 0.7% in 2010; all deficit-reducing.

Source:

April 2010 update of Stability programme (SP); Commission services' autumn 2010 forecasts (COM); Commission services' calculations

2. FINLAND

2.1. Excessive deficit procedure and most recent recommendations

The impact of the economic downturn and a discretionary fiscal stimulus triggered a deterioration of public finances in Finland. According to the April 2010 EDP notification presented by the Ministry of Finance, the authorities targeted a general government deficit of 4.1% of GDP in 2010. The Commission services' spring forecast projected a slightly smaller deficit of 3.8% of GDP in 2010. Against this background, on 13 July 2010, the Council decided that an excessive deficit existed and addressed recommendations to Finland in accordance with Article 126(7) TFEU with a view to bringing an end to this situation by

2011.[7] In its recommendations, the Council established a deadline of 13 January 2011 for effective action to be taken.

The Council recommended Finland to bring the general government deficit below 3 % of GDP in a credible and sustainable manner. Specifically, to this end, the Finnish authorities should (a) implement the fiscal measures in 2010 as envisaged in the latest update of the stability programme, while ensuring that the planned breach of the 3%-of-GDP reference value would remain contained and temporary; (b) ensure a fiscal effort of at least 0.5% of GDP in 2011; and (c) specify measures to ensure that the planned correction of the excessive deficit in 2011 is secured.

In addition, the Council invited Finland to ensure that budgetary consolidation towards the medium term objective for the budgetary position – a structural surplus of ½% of GDP – is sustained after the excessive deficit will have been corrected.

The Commission makes its assessment of action taken based on the Commission services' autumn 2010 forecast, which incorporates the 2011 budgetary measures, as well as the Ministry of Finance forecast update from 20 December 2010.

2.2. Assessment of action taken

After the deterioration of public finances from sizeable general government surpluses to a deficit of 2.5% recorded in 2009, the April 2010 EDP notification projected the deficit to widen further to 4.1% of GDP in 2010. However, the latest forecasts by both the Commission services and the authorities project a much more limited widening of the deficit in 2010. Reflecting the robust rebound of economic activity recorded since the second quarter of 2010, successive forecasts by the Commission services and the authorities have revised for the better the economic and fiscal outlook for 2010 and also for the following years. While after the initiation of the EDP no major new tax or expenditure measures were announced specifically for 2010, the improvement in economic environment has automatically boosted tax revenues. The Commission services' autumn 2010 forecast projects a deficit ratio of 3.1% of GDP in 2010, which will in turn improve the outlook for the following years compared to what was expected in spring 2010. This is a considerably better outcome than the deficit of 4.1% of GDP targeted in the authorities' April 2010 EDP notification, which underpinned the Council recommendations of 13 July 2010. Similarly, the latest Ministry of Finance forecast update from December 2010 expects the deficit to reach 3.2% of GDP in 2010 (the October 2010 EDP notification projected a deficit of 3.3% of GDP).

On the aggregate, fiscal policy was expansionary in 2010. The Commission services autumn 2010 forecast estimates the structural balance to have weakened by 1 p.p. in 2010, which reflects the share of the fiscal stimulus programme implemented in that year. The stimulus programme was carried out as envisaged in the latest update of the stability programme of February 2010 and also as recommended by the Council.

The Commission therefore concludes that Finland has followed the Council recommendations, ensuring that the planned breach of the 3%-of-GDP reference value would remain contained and temporary.

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[7] All EDP-related documents for Finland can be found at the following website: http://ec.europa.eu/economy_finance/sgp/deficit/countries/finland_en.htm

For 2011, the deficit outlook has improved considerably since the February 2010 update of the stability programme that projected a deficit of 3.0% of GDP for that year. The Commission services' autumn 2010 forecast projects a deficit of 1.6% of GDP for 2011. In its latest forecast from 20 December 2010 the authorities project a deficit-to-GDP ratio of 1.3% (similarly, in the October 2010 EDP notification a deficit of 1.4% was targeted). A major part of this improvement compared to forecasts from spring 2010 is explained by the better-than-expected economic and fiscal outcome in 2010, which carries over to 2011. However, also some discretionary tax increases have been settled over the course of 2010, improving the general government balance by some 0.6% of GDP in 2011. While no exceptional budget cuts have been announced, expenditure growth is also expected to moderate, as some of the investment projects coming from the earlier stimulus package are gradually phased out and local governments are likely to react to financing constraints by making savings in their budgets. Both the central and local governments are continuing to implement long term programmes to boost public sector productivity, which should also yield some savings in personnel costs.

The Commission forecast implies an improvement in the structural balance by slightly less than 1 p.p. in 2011. This estimate broadly corresponds to a bottom-up measurement of the size of the discretionary fiscal measures in 2011.

Against this background, the Commission concludes that Finland has ensured a fiscal effort of at least of ½ pp. of GDP in 2011 and taken effective action to put an end to the present situation of excessive deficit by 2011.

2.3. Conclusions

On current information it appears that Finland has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, Finland has taken measures to correct the excessive deficit by 2011, while ensuring an adequate fiscal effort in 2011, in line with the Council’s recommendations.

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

Table: Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012
Real GDP (% change)	COM	0.9	-8.0	2.9	2.9	2.3
	FI	0.9	-8.0	3.2	2.9	2.7
	SP	1.0	-7.6	0.7	2.4	3.5
Output gap (% of potential GDP)	COM	3.7	-6.0	-5.0	-4.0	-3.5
	FI	n.a.	n.a.	n.a.	n.a.	n.a.
	SP	3.6	-5.0	-5.2	-4.3	-2.5
General government balance (% of GDP)	COM	4.2	-2.5	-3.1	-1.6	-1.2
	FI	4.2	-2.7*	-3.2	-1.3	-0.6
	SP	4.4	-2.2	-3.6	-3.0	-2.3
Primary balance (% of GDP)	COM	5.6	-1.3	-1.8	-0.3	0.4
	FI	n.a.	n.a.	n.a.	n.a.	n.a.
	SP	5.9	-0.8	-2.3	-1.2	-0.2
Cyclically-adjusted balance (% of GDP)	COM	2.4	0.6	-0.6	0.4	0.6
	FI	n.a.	n.a.	n.a.	n.a.	n.a.
	SP	2.6	0.3	-1.1	-0.8	-1.0
Structural balance (% of GDP)	COM	2.4	0.6	-0.5	0.4	0.6
	FI	n.a.	n.a.	n.a.	n.a.	n.a.
	SP	n.a.	n.a.	n.a.	n.a.	n.a.
Government gross debt (% of GDP)	COM	34.1	43.8	49.0	51.1	53.0
	FI	34.1	43.8	47.9	50.0	51.3
	SP	34.2	41.8	48.3	52.2	54.4

Source: COM - Commission services' 2010 autumn forecast; FI –Ministry of Finance forecast update of 20 December 2010; SP - Stability Programme February 2010.
Note: The general government deficit according to EDP reporting was 2.5% of GDP in 2009*

3. BULGARIA

3.1. Excessive deficit procedure and most recent recommendations

The impact of the economic downturn and expenditure increases stemming from sizable commitments undertaken by the outgoing government ahead of the mid-year parliamentary elections in 2009 triggered a deterioration of public finances in Bulgaria. Coupled with a shift towards a less tax-intensive growth composition, this led to a general government deficit in Bulgaria of 3.9% of GDP in 2009 compared to a surplus of 1.8% in 2008.[8] Against this background, on 13 July 2010, the Council decided that an excessive deficit existed and addressed recommendations to Bulgaria in accordance with Article 126(7) TFEU with a view to bringing an end to this situation by 2011.[9] In its recommendations, the Council established a deadline of 13 January 2011 for effective action to be taken.

In particular, Bulgaria was recommended by the Council to bring the general government deficit below 3% of GDP in a credible and sustainable manner by 2011 at the latest. Specifically, to this end, the Bulgarian authorities were invited to: (a) take necessary measures to avoid a deterioration of the 2010 deficit beyond the planned 3.8% of GDP; (b) ensure a fiscal effort of at least ¾% of GDP in 2011; and (c) specify and implement the measures that

[8] With the October 2010 EDP notification the general government balance outcomes in 2008 and 2009 were revised to a surplus of 1.7% and a deficit of 4.7% of GDP, respectively. The main reasons included methodological changes with respect to introducing time-adjusted cash recording of certain tax revenues as well as some additional government liabilities uncovered in the second half of 2010.

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

are necessary to achieve the correction of the excessive deficit by 2011. To limit risks to the adjustment, the Bulgarian authorities were recommended to strengthen fiscal governance and transparency by reinforcing the Ministry of Finance's spending controls, strengthening the binding nature of the medium-term budgetary framework as well as improving the monitoring of the budget execution throughout the year.

The Council established the deadline of 13 January 2011 for the Bulgarian government to take effective action and to specify measures that will be necessary to correct the excessive deficit.

The Commission makes its assessment of action taken based on the Commission services' autumn 2010 forecast, which incorporates the budgetary measures envisaged in the 2011 budget as well as taking into account additional information provided by the Bulgarian authorities in late December 2010 and January 2011.

3.2. Assessment of action taken

In the Commission services' autumn 2010 forecast the general government deficit ratio is projected to decrease to 3.8% of GDP in 2010, from 4.7% of GDP in 2009, in line with the target set in the revised 2010 budget underpinning the Council recommendation. This projection is made against the background of a broadly unchanged economic outlook since the Commission services' spring 2010 forecast, which underpinned the Council recommendations of 13 July 2010. Furthermore, it includes a one-off deficit-increasing item resulting from cancellation of third countries' debt (0.1% of GDP) and incorporates a shortfall in current taxes and savings in capital expenditures when compared to the plans set out in the revised 2010 budget. The authorities' latest forecast projects a slightly better deficit ratio in 2010, at 3.6% of GDP. The Commission services' forecast suggests an improvement in the structural balance of around 1½% of GDP in 2010.

The Commission therefore concludes that the budgetary outcome of 2010 is expected to be in line with the Council recommendation to achieve a 2010 deficit target of 3.8% of GDP that was set in the revised 2010 budget.

For 2011, the Commission services' autumn 2010 forecast projects a deficit of 2.9% of GDP, implying an annual deficit reduction of 0.9% of GDP, based on a no-policy change assumption, an expected improvement in the economic outlook and a prudent assessment of the fiscal consolidation measures envisaged in the 2011 budget. The authorities expect a slightly lower deficit of 2.5% of GDP, with the difference mostly explained by a more optimistic projection of economic activity. They will aim to achieve this fiscal target through an increase in general government revenue, induced by the expected economic recovery and revenue-enhancing measures, as well as a containment of expenditure growth and improved spending efficiency. In structural terms, the Commission services' forecast points to an improvement in the structural balance of ¾ % of GDP in 2011.

Risks to the achievement of the 2011 deficit target mainly pertain to the macroeconomic scenario underlying the 2011 budgetary projections. A slower economic recovery with a less revenue-rich growth composition may lead to unexpected revenue shortfalls despite the conservative budget revenue estimates. On the expenditure side, local and presidential elections scheduled for the second half of 2011 may create additional spending pressures. In light of these risks, the Bulgarian authorities must closely monitor budgetary developments and be ready to take corrective measures should any of these risks materialise.

Against this background, the Commission concludes that Bulgaria has ensured a fiscal effort of ¾ pp. of GDP and taken effective action to put an end to the present situation of excessive deficit by 2011.

Finally, certain progress has been made in the area of fiscal governance and some initiatives have been undertaken to improve the efficiency of public spending. Measures for a further reform of the pension system in the medium- to long term have been agreed with the social partners, the implementation of which will require further legislative actions.

3.3. Conclusions

On current information it appears that Bulgaria has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. Bulgaria has taken the necessary measures to correct the excessive deficit by 2011 namely by avoiding a deterioration of the 2010 deficit beyond the planned 3.8% of GDP and by legislating adequate fiscal efforts in the 2011 budget, in line with the Council's recommendations.

Furthermore, the Commission is of the opinion that Bulgaria needs to be more effective in strengthening the binding nature of its medium-term budgetary framework in line with Council recommendations.

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

Table: Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012
Real GDP (% change)	COM	6.2	-4.9	-0.1	2.6	3.8
	BG	6.2	-4.9	0.2	3.6	4.7
	CP	6.0	-4.9	0.3	3.8	4.8
Output gap (% of potential GDP)	COM	4.9	-2.9	-4.8	-4.2	-2.7
	BG	n.a.	n.a.	n.a.	n.a.	n.a.
	CP	4.8	-3.5	-5.7	-4.7	-2.5
General government balance (% of GDP)	COM	1.7	-4.7	-3.8	-2.9	-1.8
	BG	1.7	-4.7	-3.6	-2.5	-1.5
	CP	1.8	-1.9	0.0	0.1	0.1
Primary balance (% of GDP)	COM	2.5	-3.9	-3.1	-2.1	-1.0
	BG	2.5	-3.9	-2.9	-1.7	-0.2
	CP	2.7	-1.3	0.9	1.0	1.1
Cyclically-adjusted balance (% of GDP)	COM	-0.1	-3.6	-2.1	-1.4	-0.9
	BG	n.a.	n.a.	n.a.	n.a.	n.a.
	CP	0.2	-0.7	1.9	1.7	1.0
Structural balance (% of GDP)	COM	-0.1	-3.6	-2.2	-1.4	-0.9
	BG	n.a.	n.a.	n.a.	n.a.	n.a.
	CP	0.2	-0.7	1.9	1.7	1.0
Government gross debt (% of GDP)	COM	13.7	14.7	18.2	20.2	20.8
	BG	13.7	14.7	15.9	19.5	18.2
	CP	14.1	14.7	14.6	14.5	14.4

Source: COM - Commission services' 2010 autumn forecast; BG - Bulgaria's Budget for 2011 and additional information provided by the authorities in January 2011; CP -Convergence Programme January 2010.

4. DENMARK

4.1. Excessive deficit procedure and most recent recommendations

The impact of the economic downturn and a discretionary fiscal stimulus triggered a deterioration of public finances in Denmark. The general government balance turned from a surplus of 3.2% of GDP in 2008 into a deficit of 2.7% of GDP in 2009, widening to an expected 5.5% of GDP in 2010. Against this background, on 13 July 2010, the Council decided that an excessive deficit existed and addressed recommendations to Denmark in accordance with Article 126(7) TFEU with a view to bringing an end to the situation of an excessive government deficit by 2013[10]. In its recommendations, the Council established a deadline of 13 January 2011 for effective action to be taken.

The Council recommended Denmark to bring the general government deficit below 3% of GDP in a credible and sustainable manner by taking action in a medium-term framework. Specifically, to this end, the Danish authorities should: (a) implement the fiscal measures in 2010 as envisaged in the latest update of the convergence programme and start consolidation in 2011 in order to bring the deficit below the reference value by 2013; (b) ensure an average annual fiscal effort of at least 0.5% of GDP over the period 2011-2013; (c) specify and rigorously implement the measures that are necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

[10] All EDP-related documents for Denmark can be found at the following website: : http://ec.europa.eu/economy_finance/sgp/deficit/countries/denmark_en.htm

The Commission makes its assessment of action taken based on the Commission services' autumn 2010 forecast and in the light of the 2011 budget, the government's December forecast and the consolidation measures presented by the government on 25 May. The assessment also takes in to account the information on effective action taken provided by the Danish Ministry of Finance to the Commission on 13 January 2011.

4.2. Assessment of action taken

The Commission services' 2010 autumn forecast points to an improvement in the general government budget balance of 1.6 pp. between 2010 and 2012 (from -5.1% of GDP in 2010 to -3.5% of GDP in 2012). In their latest macroeconomic update (December 2010) the Danish authorities project the deficit ratio at 3.6% of GDP in 2010[11], increasing to 4.7% of GDP in 2011 before declining to 3.4% of GDP in 2012, which would be close to the reference value one year before the time limit set by the Council.

In May 2010 the Danish government secured parliamentary support for a set of consolidation measures designed to fulfil the recommendations of the EDP. The measures include postponing previously planned tax cuts and temporarily suspending the automatic indexation of various tax thresholds (so-called *§20 regulation*) until 2014, reforming and shortening the unemployment benefit period from four to two years and introducing a ceiling on deductions for trade union membership fees. In addition, government consumption growth is restricted between 2011 and 2013. The measures from the May consolidation package have already been introduced into law, as recommended by the Council. In addition, the budget for 2011 reconfirms the government's intention to contain government consumption growth. Amendments to the way municipalities are financed and their expenditures controlled should reduce the risk of expenditure overruns.[12]

The Commission therefore concludes that Denmark has followed the Council recommendation to implement the fiscal measures in 2010 as envisaged in the latest update of the convergence programme and start consolidation in 2011.

The expected average annual consolidation effort from these measures over the period 2011 to 2013 amounts to about ½% of GDP, which would be in line with the Council recommendation. However, while a marked improvement in the budget balance is forecast until 2012, the structural balance is estimated to deteriorate slightly over the period. The underlying potential output growth in 2010-2013, estimated according to the commonly agreed methodology, would be very low, which is unusual and could point to uncertainties in the calculation of Danish potential output at the current juncture.

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[11] The Danish government's budget balance for 2010 is lower than the Commission services' 2010 autumn forecast primarily due to a temporary and unexpected boost of pension yield taxation revenues, which was not included in the Commission services' forecast.

[12] Two further initiatives underway are likely to have budgetary implications in the coming years. First, a students' grant reform is currently being negotiated, which could result in a reduction in the duration of student grants. The reform would thus be expected to further reduce government spending. Second, the government has proposed a phasing-out of the early retirement scheme by 2034 with an expected positive impact on long-term sustainability but with short-term budgetary costs. In particular, this reform might result in a significant one-off effect on the government budget balance in 2012. This one-off cost would not impact on the correction of the excessive deficit by 2013. It is currently not possible to adequately quantify the budgetary impacts of these two initiatives.

In view of the above consolidation measures, the Commission has, at the current juncture, no indication that the recommended fiscal effort in terms of the annual average structural balance could not be reached within the medium-term framework between 2011 and 2013. It therefore considers that Denmark has, based on current information, taken effective action to put an end to the present situation of excessive deficit by 2013.

4.3. Conclusions

On current information, it appears that Denmark has taken action representing adequate progress towards the correction of the excessive deficit within the time limit set by the Council. In particular, Denmark has implemented the fiscal measures in 2010 as envisaged in the latest update of the convergence programme and started consolidation in 2011, in line with the Council's recommendations.

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

Table 1: Comparison of key macroeconomic and budgetary projections

		2009	2010	2011	2012	2013
Real GDP (% change)	COM	-5.2	2.3	1.9	1.8	n.a.
	DK	-5.2	2.0	1.7	1.5	n.a.
	CP	-4.3	1.3	1.6	2.0	2.3
Output gap (% of potential GDP)	COM	-5.6	-3.6	-2.1	-0.8	n.a.
	DK	-3.3	-2.7	-2.1	-0.8	n.a.
	CP	-2.4	-3.0	-2.8	-2.1	-1.4
General government balance (% of GDP)	COM	-2.7	-5.1	-4.3	-3.5	n.a.
	DK	-2.8	-3.6	-4.7	-3.4	n.a.
	CP	-3.0	-5.5	-4.2	-3.2	-1.9
Primary balance (% of GDP)	COM	-0.9	-3.3	-2.4	-1.5	n.a.
	DK	n.a.	n.a.	n.a.	n.a.	n.a.
	CP	.3	-3.7	-2.3	-1.2	0.3
Cyclically-adjusted balance (% of GDP)	COM	0.9	-2.7	-2.9	-3.0	n.a.
	DK	n.a.	n.a.	n.a.	n.a.	n.a.
	CP	-1.0	-2.1	-2.0	-1.5	-0.9
Structural balance (% of GDP)	COM	0.9	-2.5	-2.9	-3.0	n.a.
	DK	-0.4	-1.9	-1.3	-0.8	-0.3
	CP	-0.6	-1.7	-1.0	-0.7	-0.2
Government gross debt (% of GDP)	COM	41.5	44.9	47.5	49.2	n.a.
	DK	41.5	43.3	43.8	47.0	n.a.
	CP	38.5	41.8	46.2	48.3	48.1

Source: COM - Commission services' 2010 autumn forecast; DK – Danish authorities December 2010 forecast and Danish Ministry of Finance assessment of action taken for the Output gap and structural balance; CP – Convergence Programme February 2010.
Notes: Statistics Denmark revised national accounts for 2008 and 2009, including total expenditure and total revenue, in November 2010, as a result also the net lending/net borrowing was revised. However, EDP net lending/net borrowing has not been revised (it will be done for the EDP notification in April 2011) this might explain the difference between the two datasets.