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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Assessment of the action taken

by Belgium, the Czech Republic, Germany, Ireland, Spain, France, Italy, the Netherlands, Austria, Portugal, Slovenia and Slovakia

in response to the Council Recommendations of 2 December 2009 with a view to bringing an end to the situation of excessive government deficit

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

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

In October 2009, capitalizing on first sign of a recovery in sight, the European Council endorsed a fiscal exit strategy based on the following principles: (i) The exit strategy should be coordinated across countries in the framework of consistent implementation of the Stability and Growth Pact. (ii) There is a need for 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. (iii) In view of the challenges, 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. (iv) 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. These principles for fiscal exit have been put into operation in the recommendations issued in the context of the excessive deficit procedures as well as in the latest round of annual assessment of Stability and Convergence Programmes. The deadlines for correction and required structural efforts have been differentiated across Member States, taking into account country-specific circumstances.

The stimulus measures in the context of the EERP coupled with the measures taken to stabilise the financial sector have prevented an economic meltdown and laid the foundation for a recovery. The Commission services' spring 2010 forecast confirms the outlook of gradual recovery consistent with withdrawal of fiscal stimulus. Indicators point towards a self-sustaining recovery at the end of 2010 and into 2011. However, significant risks remain linked to the situation in financial markets and the potential negative feedback loop between sovereign debt evolution and the banking sector. The spring 2010 forecast suggests that fiscal outcomes for the current year should be broadly in line with plans. In 2011 on the back of the expected recovery, governments' deficits are projected to begin to fall at unchanged policies.

Stability and convergence programmes of the Member States under review all confirmed the deadlines for correcting the excessive deficits foreseen in the Council Recommendations under Article 126 of the Treaty. However, in several cases the macroeconomic scenario spelled out in the programmes could be considered favourable in comparison to the Commission services' forecast. Moreover, measures to achieve the targets in the outer years of the programme period (2011 and beyond) were generally not yet spelled out in much detail and require further specification.

Developments over the past weeks have highlighted financial markets' concerns about unsustainable debt developments and prospects for growth in the EU and the euro area Member States in particular. Risk premia on sovereign debt increased sharply from the end of April to levels unprecedented in EMU, especially in Member States with the highest perceived fiscal and macro-financial risks. The unravelling of the Greek crisis induced broader financial distress and high and rising public debts raised increasing concerns on other countries' solvency. As financial market tensions persisted and escalated even after agreement on financial assistance and a fiscal and macroeconomic adjustment programme for Greece, the Council agreed on 9 May 2010 to setting up a European Financial Stabilisation Mechanism. At the same time, Ministers strongly committed to ensuring fiscal sustainability and enhanced economic growth in all Member States and agreed that plans for fiscal consolidation and structural reforms would be accelerated, where warranted.

The ECOFIN Council agreement of 9 May 2010 and the establishment of the European Financial Stabilisation mechanism represent important steps to safeguard the stability of the euro area and EU economy. The benefits need to be secured through further policy actions addressing the fiscal challenges head on. An effective and coordinated short and longer term response is needed. The policy response must come from differentiated fiscal consolidation and bold supply side measures tailored also to remove obstacles to domestic demand.

In the most vulnerable countries, the consolidation effort will take place in a particularly adverse economic environment of low output growth, high unemployment and deflationary pressures. These conditions render consolidation and reversal of debt dynamics particularly challenging. However, in the current climate of renewed risk aversion delivering on the nominal budgetary targets even against a less favourable than assumed economic environment may be necessary in order to avoid destabilising debt dynamics for all but the least exposed countries. Frontloading fiscal consolidation and early decision of additional measures, as well as structural reforms, would bolster confidence, both domestically and in financial markets, in the ability to reverse the adverse debt dynamics.

To avoid choking the nascent recovery, an undifferentiated rush for unprecedented fiscal consolidation should be avoided. Instead, a coordinated and differentiated approach to accelerated fiscal consolidation would further enhance market confidence and contribute to fiscal sustainability by taking explicitly into account interdependence across countries. Such a differentiated approach is needed to optimise the fiscal exit strategy at the EU level: some countries need to do more because they face greater risks and, by the same token, because the credibility and coherence of the entire EU exit strategy is at stake. Countries most exposed to macro-financial risks need to pursue and, where warranted, strengthen their consolidation effort as the cost of inaction would be far larger than the potential short-run negative impact of fiscal consolidation on growth. Others should stick to their targets as agreed in their stability and convergence programmes. Finally, some need to adopt early decision of consolidation in order to substantiate their consolidation strategy.

The following assessment of effective action taken by the twelve Member States in response to the recommendations of 2 December 2009 takes place against the background outlined above. The recommendations were issued and the corresponding measures taken in the context of the exit strategy outlined by the October 2009 European Council. In the light of the most recent developments and according to 9 May ECOFIN Council conclusions also an assessment of the new targets and additional measures by Spain and Portugal is presented in annex 2.

2. ASSESSMENT OF ACTION TAKEN

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

On 2 December 2009, the Council addressed recommendations under Article 126(7) TFEU to Belgium, the Czech Republic, Germany, Italy, Netherlands, Austria, Portugal, Slovenia and Slovakia and revised recommendations under the same Article to France, Spain, Ireland and the United Kingdom with a view to bringing the situation of an excessive deficit to an end[1]. These recommendations were based on the Commission services' autumn 2009 forecast and on the agreed principles of the fiscal exit strategy. The Council set the date of 2 June 2010 for taking effective action in response to the recommendations.

According to Regulation (EC) No 1467/97[2] 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 other temporary measures, initially recommended by the Council. In case the observed adjustment proves to be lower than recommended, a careful analysis of the reasons for the

1 An overview of all past and ongoing EDP procedures is available at: http://ec.europa.eu/economy_finance/sgp/deficit/countries/index_en.htm

2 OJ L 209, 2.8.1997, p. 6.

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.

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 Belgium, the Czech Republic, Germany, Ireland, Spain, France, Italy, the Netherlands, Austria, Portugal, Slovenia and Slovakia, in response to the Council recommendations of 2 December[4]. The Commission considers that for these countries, 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 1.

Moreover, in view of the call of the ECOFIN Council of 9 May 2010 to accelerate plans for fiscal consolidation and structural reforms where warranted, the Commission welcomes the important additional measures and more ambitious targets for the budget balance in 2010 and 2011 in Spain and Portugal. In both countries, these new consolidation measures underpin an appropriate and ambitious downward revision of the 2010 and 2011 deficit targets (in comparison with the plans outlined in the 2010 stability programme updates). These measures will also lead to a parallel improvement in the Commission services' deficit forecast for these years. Spain and Portugal are expected, at the same time, to specify measures in their 2011 budget amounting to 1¾% and 1½% of GDP respectively in order to attain the improvement foreseen in their stability programme and reduce budgetary risks. This assessment should be considered as early guidance of next year's budget. This is very much in line with proposals on reinforced economic governance which foresees early guidance in order to ensure a sound articulation between the European and national budgetary process. A more detailed assessment of the new targets and measures for Spain and Portugal is presented in Annex 2.

Overall, the current budgetary targets, including recent revisions reflecting the need to frontload in the countries most at risk, appear to strike an adequate balance between the need to secure the incipient signs of economic recovery and the cost of fiscal retrenchment. Irrespective of the size of the consolidation, two features are likely to influence its success: the degree of policy commitment, reflected by the permanent nature of the measures, and the composition of consolidation, with revenue-based measures likely to be less effective because of the negative repercussions on growth, but with important distinctions linked to tax structure and design, as well as the starting level of the tax burden.

The Commission will continue to closely monitor budgetary developments in accordance with the Treaty and the Stability and Growth Pact (SGP).

4 For the UK, which also received recommendations under Article 126(7) TFEU on 2 December 2009, the Commission postponed its assessment until the presentation of the emergency budget announced by the new British government for 22 June 2010.

ANNEX 1: ASSESSMENT OF ACTION TAKEN BY COUNTRY

1. BELGIUM

1.1. Excessive deficit procedure and most recent recommendations

On 2 December 2009, the Council decided that an excessive deficit existed in Belgium in accordance with Article 126(6) of the Treaty on the Functioning of the European Union (TFEU) and addressed recommendations to Belgium in accordance with Article 126(7) with a view to bringing an end to the situation of an excessive government deficit[5].

The Council recommended Belgium to put an end to the present excessive deficit situation by 2012. The Belgian authorities should 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 Belgian authorities should: (a) implement the deficit-reducing measures in 2010 as planned in the draft budget for 2010, and strengthen the planned fiscal effort in 2011 and 2012; (b) ensure an average annual fiscal effort of ¾ % of GDP over the period 2010-2012, 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; (c) specify 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; (d) strengthen monitoring mechanisms to ensure that fiscal targets are respected.

In addition, the Belgian authorities should seize opportunities beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the reference value.

The Council established the deadline of 2 June 2010 for the Belgian government to take effective action to implement the deficit-reducing measures in 2010 as planned in the draft budget for 2010 and to outline in some detail the strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

1.2. Assessment of action taken

The global economic and financial crisis led to a contraction of economic activity in Belgium of 3% in 2009. The rebound in global demand triggered the recovery of economic growth in the second half of 2009. According to the Commission services' 2010 spring forecast, this recovery is expected to continue in 2010 and 2011, leading to real GDP growth of 1.3% and 1.6%, respectively. For 2010, this means that the outlook for 2010 has improved considerably since the Commission services' 2009 autumn forecast, which had projected real GDP growth of 0.6%, whereas it remained relatively stable for 2011. The output gap is expected to gradually diminish over the forecast horizon.

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

Regarding 2010, the authorities broadly implemented the deficit-reducing measures in 2010 planned in the draft budget for 2010 as recommended by the Council except for an additional expenditure of less than 0.1% of GDP, in the areas of security and active labour market policies, financed from windfall revenues decided in the context of the March 2010 budgetary control exercise. The most recent projections of the Belgian authorities, as reported in the May 2010 update of the budget foresee a deficit of 4.8% of GDP compared to 6.0% of GDP in 2009; the spring forecast of 5.0% of GDP is slightly more pessimistic, mainly resulting from less positive tax elasticity assumptions, notably corporate taxes. In any case, both forecasts represent a considerable improvement compared to the projected deficit of 5.6% of GDP in the authorities' budget, presented to Parliament on 6 November 2009. The 2010 deficit is expected to benefit somewhat from additional consolidation measures taken by other government tiers, but mainly from the more favourable macro-economic environment. This is broadly in line with the recommendation to accelerate deficit reduction if economic and budgetary conditions turn out better than expected.

According to the spring forecast the structural balance improves by ¼% of GDP, which is lower than the planned consolidation of ½% of GDP foreseen in the stability programme, but still in line with the Council recommendations to start consolidation in 2010. The structural change in 2010 can be explained by consolidation measures of 1% of GDP which are largely offset by an increasing expenditure trend. This consolidation includes the partial withdrawal of the stimulus package, improving the budget by ¼% of GDP, as well as a consolidation package concentrated on the revenue side and largely consisting of several tax increases and non-tax revenues from the financial sector. The increasing expenditure trend of ½% of GDP is the result of previously taken measures and the budgetary impact of population ageing and also reflects rising interest expenditure. Overall, the expected structural improvement in 2010 falls short of the average annual fiscal effort of ¾% of GDP as recommended under Article 126(7), which will require above-average fiscal effort for the period 2011-2012.

The main goal of the medium-term budgetary strategy is to correct the excessive deficit by 2012, in line with the Council recommendation under Article 126(7) of 2 December 2009. To this end, the programme targets an improvement of the headline deficit from 5.9% of GDP in 2009 to 4.8% in 2010, 4.1% in 2011 and 3.0% in 2012. However, as concluded by the Council in its opinion of the latest update of the stability programme, measures underpinning the target for 2011 are only partly specified and there are no measures specified for 2012. In addition, the slightly favourable macroeconomic assumptions combined with an average annual fiscal effort that is somewhat below the ¾% of GDP recommended by the Council, pose further downward risks to the targets. Therefore, the strategy would need to be backed up by fully specified measures as from 2011 and additional measures need to be considered to ensure the correction of the excessive deficit by 2012, as recommended by the Council.

The debt level, which was on a downward trend since 1993, is on an increasing trend since 2008. According to the stability programme, it will reach 101½% of GDP in 2011, before falling slightly to 100½% of GDP in 2012. Risks to these projections are related to the favourable budgetary targets from 2011 in the programme. The spring forecast projects the debt to reach 101% of GDP in 2011, which is slightly more optimistic, mainly resulting from a lower debt level in 2009 than was expected in the programme.

In the stability programme, improvements are announced regarding the fiscal framework aimed at strengthening monitoring mechanisms to ensure that fiscal targets are respected. These include the introduction of multi-annual budgetary agreements among all government tiers, some steps towards multi-annual budgeting at the federal level, regular and stringent control budget exercises and improvements to the reporting system of local governments. Nevertheless, more could be done, for example by creating enforceable, multi-annual expenditure ceilings.

1.3. Conclusions

On current information it appears that Belgium has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, Belgium is broadly implementing the deficit-reducing measures in 2010 as planned in the draft budget, totalling 1% of GDP and leading to an improvement in the structural balance of ¼% of GDP. Furthermore, the 2010 headline deficit is expected by the Commission services to come out lower than the deficit for 2010 projected in the draft budget, at 5% of GDP and 5.6% of GDP respectively.

The Belgian authorities have outlined in some detail the consolidation strategy, by setting targets and indicating a number of measures supporting them, which is necessary to progress towards the correction of the excessive deficit by 2012, the deadline recommended by the Council. However, the measures underpinning the envisaged consolidation path from 2011 onwards will need to be specified further in order to reach the recommended average annual fiscal effort and to correct the excessive deficit by the deadline and to ensure that the debt ratio embarks on a downward path by the end of the correction period. Also, Belgium should further strengthen monitoring mechanisms to ensure that fiscal targets are respected. In view of the above, it would be important for Belgium to take action to specify consolidation measures for the coming years in order to ensure a timely correction of the excessive deficit.

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

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012
Real GDP (% change)	COM	2.9	1.0	-3.1	1.3	1.6	n.a.
	SP	n.a.	1.0	-3.1	1.1	1.7	2.2
Output gap[1] (% of potential GDP)	COM	2.3	1.5	-2.7	-2.4	-1.9	n.a.
	SP	n.a.	1.8	-2.4	-2.5	-2.2	-1.4
General government balance (% of GDP)	COM	-0.2	-1.2	-6.0	-5.0	-5.0	n.a.
	SP	n.a.	-1.2	-5.9	-4.8	-4.1	-3.0
Primary balance (% of GDP)	COM	3.6	2.6	-2.3	-1.3	-1.2	n.a.
	SP	n.a.	2.6	-2.3	-1.1	-0.4	0.8
Cyclically-adjusted balance[1] (% of GDP)	COM	-1.4	-2.0	-4.5	-3.7	-4.0	n.a.
	SP	n.a.	-2.2	-4.6	-3.4	-2.9	-2.2
Structural balance[2] (% of GDP)	COM	-1.3	-2.1	-3.9	-3.8	-4.0	n.a.
	SP	n.a.	-2.2	-3.8	-3.4	-2.9	-2.2
Government gross debt (% of GDP)	COM	84.2	89.8	96.7	99.0	100.9	n.a.
	SP	n.a.	89.8	97.9	100.6	101.4	100.6

Note:

[1] Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on of the information in the programmes.
[2] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Commission services' 2010 spring forecast (COM) and January 2010 stability programme update (SP)

2. THE CZECH REPUBLIC

2.1. Excessive deficit procedure and most recent recommendations

On 2 December 2009, the Council decided that an excessive deficit existed in the Czech Republic in accordance with Article 126(6) of the Treaty on the Functioning of the European Union (TFEU) and addressed recommendations to the Czech Republic in accordance with Article 126(7) with a view to bringing an end to the situation of an excessive government deficit[6].

The Council recommended the Czech Republic to put an end to the present excessive deficit situation by 2013. The Czech authorities should 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 Czech authorities should: (a) implement the deficit reducing measures in 2010 as planned in the draft budget law for 2010; (b) ensure an average annual fiscal effort of 1% of GDP over the period 2010-2013; (c) specify 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.

To limit the risks to the adjustment, the Czech Republic should enforce rigorously its medium-term budgetary framework and improve the monitoring of the budget execution throughout the year to avoid expenditure overruns compared to the budget and multiannual plan.

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

The Council established the deadline of 2 June 2010 for the Czech government to take effective action to implement the deficit reducing measures in 2010 as planned in the draft budget law for 2010 and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

2.2. Assessment of action taken

The Czech economy did not avoid a sharp recession due to the crisis, with real GDP falling by 4.2% in 2009. In line with the improving global economic environment, growth became positive in the third quarter of 2009. Moreover, the outlook in the latest Commission services' spring 2010 forecast is more favourable than envisaged last autumn. Real GDP is now expected to grow by 1.6% and 2.4% in 2010 and 2011 respectively, while in autumn 2009 the Commission services projected a growth of 0.8% and 2.3%. The government deficit increased to 5.9% of GDP in 2009 (from 2.7% of GDP in 2008), reflecting anti-crisis measures of around 2% of GDP and the operation of automatic stabilisers. This was a better outcome than the 6.6% of GDP expected by the Commission services and the authorities in autumn 2009.

Given the risks related to rising deficits, the government decided to withdraw fiscal stimulus at the end of 2009 and start fiscal consolidation already in 2010. A consolidation package was approved as part of the draft budget for 2010. It relies predominantly on revenue side measures, including increases in VAT, excise duties, property taxes and social security ceilings for high-income earners. Stimulus measures such as temporary cuts in social security contributions were withdrawn earlier than planned. Expenditure side measures include cuts in social benefits and the public sector wage bill and a freeze of pensions in 2010. The overall impact of the consolidation measures in 2010 is estimated at 2.1% of GDP.

In the February 2010 Convergence Programme, the authorities targeted a government deficit of 5.3% of GDP and a 2 pp. improvement in the structural balance. The Commission services' spring 2010 forecast expects the deficit to reach 5.7% of GDP, and an improvement in the structural balance by 0.5 pp. The gap in the estimated structural effort is partly due to a base effect: the downward revision of the 2009 deficit to 5.9% of GDP was taken into account in the spring 2010 forecast but not in the convergence programme. The lower deficit in 2009 did however not translate into a lower 2010 deficit in the Commission services' forecast because of lower projected revenues and, to a lesser extent, higher expected deficits of local budgets and additional expenditure approved before the parliamentary elections (around 0.1% of GDP).

According to the Commission services' forecast, the fiscal effort as measured by the change in the structural balance in 2010 is therefore lower than the 1% of GDP (on average over 2010-2013) recommended by the Council. This reflects a low tax-to-GDP elasticity in 2010 – while revenue side consolidation measures are estimated to some 1.8% of GDP, the Commission services' spring 2010 forecast projects an increase in the revenue-to-GDP ratio of only 1 percentage point. The fiscal effort is higher than recommended when using the bottom-up approach based on the Czech authorities' estimates of the fiscal impact of consolidation measures. These measures have been fully implemented, in line with the Council recommendation.

Taking into account data for the first months of 2010, the authorities identified risks to the budgetary execution in 2010. They stem from lower tax revenue and property income and higher-than-expected spending of local authorities. Nevertheless, in a letter of 27 May 2010, the authorities reiterated their strong commitment to the 5.3% of GDP deficit target for 2010. To this end, the government adopted additional measures amounting to around ¼% to ½% of GDP which have not been taken into account in the Commission services' spring 2010 forecast and which include: setting limits on expenditure in individual budget chapters, using dividends from state-owned enterprises for deficit reduction and postponing payment of past environmental damage claims.

Beyond 2010, the Czech authorities aim at reducing the government deficit to 4.8% and 4.2% of GDP in 2011 and 2012 respectively and at reaching the 3% deficit target in 2013, in line with the Council Recommendation. The budgetary targets are nevertheless subject to risks. The medium-term budgetary strategy outlines in broad terms the consolidation path but does not provide details on concrete measures, in particular on the expenditure side. Furthermore, no measures are specified for 2013 while a significant reduction of the general government deficit by 1.2 pp. is assumed, thus implying a back-loaded consolidation path. In the letter of 27 May 2010, the authorities inform about their intention to revise the medium-term expenditure ceilings for 2011-2013 in order to align them with the above mentioned fiscal targets. This revision as well as more details on the consolidation measures will be included in the Ministry of Finance's Fiscal Outlook due in June 2010.

The Czech authorities have not announced any further measures to improve enforcement the medium-term budgetary framework. Some progress has however been made to improve budgetary execution. The ongoing implementation of changes in tax collection and tax management as well as a shift to a treasury system of budgetary management will contribute to more efficient management of public finances.

2.3. Conclusions

On current information it appears that the Czech Republic has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, the Czech authorities have implemented the deficit reducing measures in 2010 as planned in the draft budget law for 2010 and have taken some additional measures in the course of the year to reach the 2010 deficit target. Overall, the fiscal impact of the measures is estimated at more than 2% of GDP.

The Czech authorities have outlined in some detail the consolidation strategy needed to correct the excessive deficit by 2013, the deadline recommended by the Council. However, to achieve the planned consolidation strategy it will be important to ensure rigorous budgetary execution in 2010 and stand ready to adopt additional measures if necessary to reach the 5.3% of GDP deficit target. Furthermore, it is necessary to adopt a budget for 2011 consistent with Council recommendations and to specify in more detail consolidation measures for 2012 and 2013. Some progress has been made in improving the monitoring of the budget execution throughout the year, as the Council recommended, but further measures to improve enforcement of the budgetary framework will be needed.

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

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013
Real GDP (% change)	COM	6.1	2.5	-4.2	1.6	2.4	n.a.	n.a.
	CP	n.a.	2.5	-4.0	1.3	2.6	3.8	n.a.
Output gap[1] (% of potential GDP)	COM	6.0	4.8	-2.2	-2.7	-2.5	n.a.	n.a.
	CP	n.a.	5.6	-2.0	-2.9	-2.6	-1.1	n.a.
General government balance (% of GDP)	COM	-0.7	-2.7	-5.9	-5.7	-5.7	n.a.	n.a.
	CP	n.a.	-2.1	-6.6	-5.3	-4.8	-4.2	n.a.
Primary balance (% of GDP)	COM	0.5	-1.6	-4.6	-3.9	-3.6	n.a.	n.a.
	CP	n.a.	-1.0	-5.3	-3.5	-2.8	-2.0	n.a.
Cyclically-adjusted balance[1] (% of GDP)	COM	-2.9	-4.5	-5.1	-4.7	-4.8	n.a.	n.a.
	CP	n.a.	-4.5	-5.9	-4.2	-3.8	-3.8	n.a.
Structural balance[2] (% of GDP)	COM	-2.9	-4.5	-5.4	-4.9	-4.9	n.a.	n.a.
	CP	n.a.	-4.5	-6.1	-4.1	-3.7	-3.5	n.a.
Government gross debt (% of GDP)	COM	29.0	30.0	35.4	39.8	43.5	n.a.	n.a.
	CP	n.a.	30.0	35.2	38.6	40.8	42.0	n.a.

Note:

[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] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Commission services' 2010 spring forecast (COM) and February 2010 convergence programme update (CP)

3. GERMANY

3.1. Excessive deficit procedure and most recent recommendations

On 2 December 2009, the Council decided that an excessive deficit existed in Germany in accordance with Article 126(6) of the Treaty on the Functioning of the European Union (TFEU) and addressed recommendations to Germany in accordance with Article 126(7) with a view to bringing an end to the situation of an excessive government deficit[7].

The Council recommended the Germany's authorities to implement the fiscal measures in 2010 as envisaged and, starting consolidation in 2011, put an end to the present excessive deficit situation by 2013.

The German authorities should 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 German authorities should: (a) ensure an average annual fiscal effort of at least 0,5 % of GDP over the period 2011-2013, 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; (b) specify 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.

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

In addition, the German authorities should seize any opportunity beyond the fiscal efforts, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the reference value.

The Council established the deadline of 2 June 2010 for the German government to take effective action to implement the fiscal measures in 2010 as envisaged and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action takes into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

3.2. Assessment of action taken

According to the Commission services' spring 2010 forecast, real GDP is projected to increase by 1.2% in 2010 and 1.6% of GDP in 2011 which does not differ substantially from the autumn 2009 projection (0.1 pp. lower growth in 2011). The Commission services expect a relatively steady but moderate recovery, which would initially be mainly export-led but then spill over into stronger domestic demand. Given the remarkable resilience of the labour market, the employment outlook has become more favourable. The negative output gap is expected to diminish slightly in 2010 and 2011.

According to the February 2010 update of the Stability Programme, the general government deficit is likely to increase by around 2¼ pp. to 5½% of GDP in 2010. This widening of the deficit in 2010 is mainly fuelled by fiscal stimulus measures introduced in line with the European Economic Recovery Plan (EERP) and to a lesser extent by the impact of automatic stabilisers. General government revenue is projected to shrink by almost 2% of GDP on the back of household relief measures and weaker domestic demand. The expected increase in general government expenditure by around ½% of GDP can be mainly attributed to the previously-projected increase in unemployment and continued investment in public infrastructure. Given the improved outlook for the labour market, the Commission services' spring 2010 forecast expects a general government deficit of 5% of GDP in 2010.

The federal budget for 2010, approved in March 2010, set the federal deficit target at 3¼% of GDP. According to the February 2010 update of the Stability Programme, the deficit of the aggregated budgets of the state and local government is projected to amount to 2% of GDP, while the budgets of the social security systems are likely to be almost balanced. In 2010, major measures in the general government budget encompass: (1) the package of 27 January 2009 (*Konjunkturpaket II*) including a higher basic personal income tax allowance, (2) the Citizens' Relief Act (*Bürgerentlastungsgesetz*) of 16 July 2009 establishing tax deductibility of health-care and long-term care contributions and (3) the Act to Accelerate Economic Growth (*Wachstumsbeschleunigungsgesetz*) raising, *inter alia*, child allowances. While some of the stimulus measures expired at the end of 2009 (e.g. car scrapping premium), others continue in 2010 and may even have a higher budgetary impact than in 2009 (e.g. the reduced contribution rate to the health-care insurance, introduced as of mid-2009). Moreover, some measures will come into effect with a lag, e.g. additional infrastructure investment.

According to the February 2010 update of the Stability Programme, the main goal of the medium-term budgetary strategy is to correct the excessive deficit by 2013 with an average annual fiscal effort of almost ¾% of GDP in 2011-2013, which is in line with the Council Recommendation of 2 December 2009. The envisaged adjustment path is based on the technical assumption of expenditure-driven consolidation at the federal level, which is related to the consolidation requirements implied by the new constitutional budgetary rule. The rule prescribes a federal structural deficit ceiling of 0.35% of GDP as of 2016 and balanced structural budgets for the *Länder* from 2020 onwards. The new budgetary rule – being an important consolidation anchor – still remains to be implemented at all levels of governments.

On 7 June 2010, the German government announced budgetary consolidation measures for the period 2011-2014 at the federal level. Major retrenchment steps include cuts in certain social and family benefits (including, inter alia, reduced support for unemployed, abolition of federal coverage of pension insurance contributions for the long-term unemployed, abolition of parental allowance for the long-term unemployed) and cost savings in the public sector (including wage restraint and employment cuts). Additional revenue is expected from the abolition of eco-tax subsidies, a new air traffic charge and new levies on the nuclear energy and banking sectors. The expected average annual consolidation effort at the federal level over the period 2011-2013/14 amounts to ¼% of GDP. The German government is to adopt the draft 2011 federal budget and the federal medium-term financial plan 2011-2014 at the end of June/beginning of July. The general government budgetary strategy is to be discussed with the *Länder* and the communes in a working group of the new national Stability Council on 14 July[8].

As presented in the latest update of the Stability Programme, the debt-to-GDP ratio has increased rapidly by 6½ pp. to 72½% of GDP in 2009[9] – driven by a sharp increase in net borrowing, financial market stabilisation measures and a decline of the nominal GDP. It is set to increase to 82% of GDP in 2013. In addition to all risks attached to the deficit path, there is still some risk of further debt increases related to financial market stabilisation measures and to the uncertainty regarding the sector classification of debt related to "bad banks" out of public banks. The Commission expects the debt to amount to around 81½% in 2011. The difference of 2 pp., as compared to the latest national projection, is mainly explained by a technical assumption that the establishment of a "bad-bank" for one of the *Landesbanken* has a direct impact on the debt[10].

3.3. Conclusions

On current information it appears that Germany not only has taken action representing adequate progress towards the implementation of the Council Recommendations under Article 126(7) TFEU of 2 December 2009, but also presented budgetary consolidation measures for the period 2011-2014. In particular, the German authorities have implemented the fiscal stimulus measures in 2010 as planned, including the additional tax relief measures introduced by the Act to Accelerate Economic Growth.

The German authorities have also outlined in some detail a medium-term budgetary strategy to correct the excessive deficit by 2013 with an average annual fiscal effort of almost ¾% of GDP in 2011-2013. In particular, the German authorities have announced specific consolidation measures over 2011-2014 at the federal level. To what extent these will feed through to the general government balance and ensure the correction of the excessive deficit by 2013 will also depend on the budgetary strategies followed by the Länder and local

8 Letter from the German Minister of Finance W. Schäuble to the Commissioner O. Rehn (27.5.2010).

9 According to the Bundesbank estimate from May, 2010, the debt–to-GDP ratio stood at 73.1% in 2009.

10 This treatment follows the practice currently used by the German statistical authorities and does not prejudge the final accounting decision.

communities. In particular, the national budgetary rule is still to be transposed to the sub-federal level.

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

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013
Real GDP (% change)	COM	2.5	1.3	-5.0	1.2	1.6	n.a.	n.a.
	SP	2.5	1.3	-5.0	1.4	2	2	2
Output gap[1] (% of potential GDP)	COM	2.7	3.0	-2.9	-2.7	-2.3	n.a.	n.a.
	SP	2.0	3.2	-2.6	-2.1	-1.3	-1.1	-0.9
General government balance (% of GDP)	COM	0.2	0.0	-3.3	-5.0	-4.7	n.a.	n.a.
	SP	-0.2	0.0	-3.2	-5½	-4½	-3½	-3
Primary balance (% of GDP)	COM	3.0	2.7	-0.7	-2.3	-2.0	n.a.	n.a.
	SP	2.6	2.7	-0.6	-3	-2	-½	½
Cyclically-adjusted balance[1] (% of GDP)	COM	-1.2	-1.5	-1.8	-3.6	-3.5	n.a.	n.a.
	SP	-1.2	-1.6	-1.9	-4.4	-4.1	-3.1	-2.3
Structural balance[2] (% of GDP)	COM	-1.2	-1.1	-1.7	-3.6	-3.5	n.a.	n.a.
	SP	-0.9	-1.2	-1.8	-4.4	-3.9	-3.0	-2.3
Government gross debt (% of GDP)	COM	65.0	66.0	73.2	78.8	81.6	n.a.	n.a.
	SP	65.1	65.9	72½	76½	79½	81	82

Note:

[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] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Commission services' 2010 spring forecast (COM) and February 2010 stability programme update (SCP)

4. IRELAND

4.1. Excessive deficit procedure and most recent recommendations

On 27 April 2009, the Council decided that an excessive deficit existed in Ireland in accordance with Article 104(6) of the Treaty establishing the European Community (TEC). The most recent Council Recommendation under Article 126(7) of the Treaty on the Functioning of the European Union (TFEU) was adopted on 2 December 2009[11].

The Council recommended Ireland to put an end to the present excessive deficit situation by 2014.

The Irish authorities should 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 Irish authorities should: (a) specify consolidation measures in the budget for 2010 in line with the package announced in the April 2009 supplementary budget; (b) ensure

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

an average annual fiscal effort of 2 % of GDP over the period 2010-2014, which should also contribute to bringing the government gross debt ratio back on a declining path that approaches the 60 % of GDP reference value at a satisfactory pace by restoring an adequate level of the primary surplus; (c) specify the measures that are necessary to achieve the correction of the excessive deficit by 2014, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

In addition, the Irish authorities should seize opportunities 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.

To limit risks to the adjustment, Ireland should strengthen the enforceable nature of its medium-term budgetary framework as well as closely monitor adherence to the budgetary targets throughout the year. To reduce the risks to the long-term sustainability of public finances, the Irish authorities should pursue further reforms to the social security system as soon as possible.

The Council established the deadline of 2 June 2010 for the Irish government to take effective action to specify consolidation measures in the budget for 2010 in line with the package announced in the April 2009 supplementary budget and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

4.2. Assessment of action taken

According to the Commission services' spring 2010 forecast, the outlook for real activity in Ireland is slightly better than expected at the time the Council issued its recommendations in December 2009. After a fall by an estimated 7.1% in 2009, a further decline in real GDP by 0.9% is now expected in 2010, followed by an expansion by 3.0% in 2011, implying an upward revision of around ½ percentage point for all years vis-à-vis the Commission services' autumn 2009 forecast. However, more subdued inflationary developments than previously projected imply a slight downward revision of the nominal GDP level.

The general government deficit stood at 14.2% of GDP in 2009, compared to an estimate of 12.5% of GDP in the autumn 2009 forecast. The upward revision mainly reflects a one-off capital injection into Anglo Irish bank of 2.4% of GDP, which was reclassified as a deficit-increasing capital transfer. Excluding this item, the underlying deficit of 11.8% of GDP was better than expected in the autumn forecast. This is explained by a lower-than-expected revenue ratio by ¼ percentage point to GDP, which was more than offset by a lower expenditure ratio by almost 1 percentage point, mainly on the capital side.

For 2010, the deficit target is 11.6% of GDP in the December 2009 stability programme (revised to 11.5% of GDP in the April 2010 EDP notification in view of the revised expenditure estimates for central government). To reach the target, the authorities implemented a significant savings package of 2.5% of GDP in the budget for 2010, broadly as announced in the April 2009 supplementary budget and thus broadly in line with the Council recommendation. Nearly all of the adjustment effort is on the expenditure side, including public sector wage cuts, social welfare savings, other current savings and a reduction in public investment, each contributing in broadly equal measure to the overall package. On the revenue side, the effect of a new carbon tax is broadly offset by a reduction in the standard VAT rate and in excise duties on alcohol. Overall, the net deficit-reducing thrust for 2010 is estimated at 4¼% of GDP, including the full-year effect of measures taken in the course of 2009. The Commission services' spring 2010 forecast projects a deficit of 11.7% of GDP. The small difference with the official target is largely due to lower nominal growth projected in the spring forecast. The structural deficit, i.e. the cyclically-adjusted deficit excluding one-off and other temporary measures, is estimated to stay broadly unchanged compared to 2009 despite the significant consolidation package exceeding the recommended average fiscal effort of 2% of GDP over the period 2010-14. This is explained by the ongoing underlying deterioration of the fiscal position on a no-policy change basis.

After 2010, the stability programme targets a gradual reduction of the deficit to below 3% of GDP by 2014, the correction deadline set by the Council. To reach the targets, quantified consolidation efforts on the current and capital side of the budget are envisaged but no broad measures are outlined. In its opinion of 26 April 2010 on the programme, the Council stated that the deficit targets for 2011-14 need to be backed up by concrete measures and that the plans for the entire period need to be strengthened to address the risks from less favourable GDP growth and possible expenditure slippages.

According to the stability programme, gross general government debt stood at 64% of GDP in 2009 and is expected to be on an increasing trend until 2012, when it would reach nearly 84% of GDP and then start to gradually decline. The Council Opinion highlighted risks to the debt projections, related to further capital injections into banks and the negative risks to the budgetary targets. The Commission services' spring 2010 forecast projects the debt ratio to rise to 83% of GDP in 2011 on a no-policy change basis.

Regarding the Council's recommendation to strengthen the budgetary framework, the stability programme indicates that further reforms are being considered, such as the introduction of binding multi-annual envelopes for current expenditure and a fiscal rule stipulating the use of future windfall profits for deficit reduction purposes. Finally, concerning the Council's recommendation on long-term sustainability, the programme contains some indications on plans for public sector pension reform and, on 3 March 2010, the authorities published the "National Pensions Framework" setting out their plans for broader pension reform, including a gradual increase in the age at which people qualify for the State pension by three years.

4.3. Conclusions

On current information it appears that Ireland has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, the authorities implemented a significant savings package for 2010 of 2.5% of GDP, broadly in line with the Council's recommendation.. Beyond 2010, the authorities have outlined in some detail a medium-term consolidation strategy by laying out deficit targets and quantifying packages to reach them with a view to correcting the excessive deficit by 2014, the deadline recommended by the Council. In order to achieve the targets, it will be important to spell out the measures underlying the consolidation efforts and to address the downside risks to the budgetary targets, also to ensure that the debt ratio would embark on a downward path before the end of the programme period. In view of the above, it would be important for Ireland to take action to specify consolidation measures for the coming years in order to ensure a timely correction of the excessive deficit.

Improvements to long-term sustainability as recommended by the Council could usefully build on the pension reform measures that have recently been announced by the government, while also for the recommended strengthening of the budgetary framework some measures are currently under consideration.

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

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013	2014
Real GDP (% change)	COM	6.0	-3.0	-7.1	-0.9	3.0	n.a.	n.a.	n.a.
	SP	n.a.	n.a.	-7.5	-1.3	3.3	4.5	4.3	4.0
Output gap[1] (% of potential GDP)	COM	4.4	-0.5	-7.2	-7.3	-4.7	n.a.	n.a.	n.a.
	SP	n.a.	0.0	-7.0	-7.6	-4.6	-2.2	-0.6	0.1
General government balance (% of GDP)	COM	0.1	-7.3	-14.3	-11.7	-12.1	n.a.	n.a.	n.a.
	SP	n.a.	-7.2	-11.7	-11.6	-10.0	-7.2	-4.9	-2.9
Primary balance (% of GDP)	COM	1.2	-5.9	-12.2	-8.8	-8.6	n.a.	n.a.	n.a.
	SP	n.a.	-6.1	-9.6	-8.8	-6.6	-3.4	-1.0	1.0
Cyclically-adjusted balance[1] (% of GDP)	COM	-1.6	-7.0	-11.4	-8.7	-10.2	n.a.	n.a.	n.a.
	SP	n.a.	-7.2	-8.9	-8.6	-8.2	-6.3	-4.7	-2.9
Structural balance[2] (% of GDP)	COM	-1.6	-7.0	-9.4	-9.3	-10.2	n.a.	n.a.	n.a.
	SP	n.a.	-6.4	-9.3	-9.2	-8.2	-6.3	-4.7	-2.9
Government gross debt (% of GDP)	COM	25.0	43.9	64.0	77.3	87.3	n.a.	n.a.	n.a.
	SP	n.a.	n.a.	64.5	77.9	82.9	83.9	83.3	80.8

Note:

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

[2] Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.8% of GDP in 2008 (deficit-increasing), 0.4% of GDP in 2009 and 0.6% of GDP in 2010 (both deficit-reducing) according to the programme and 2.0% of GDP in 2009 (deficit-increasing) and 0.6% of GDP in 2010 (deficit-reducing) according to the Commission services' spring 2010 forecast.

Source: Commission services' 2010 spring forecast (COM) and December 2009 stability programme update (SP)

5. SPAIN

5.1. Excessive deficit procedure and most recent recommendations

On 27 April 2009, the Council decided that an excessive deficit existed in Spain in accordance with Article 104(6) of the Treaty establishing the European Community (TEC). The most recent Council Recommendation under Article 126(7) of the Treaty on the Functioning of the European Union (TFEU) was adopted on 2 December 2009[12].

The Council recommended Spain to put an end to the present excessive deficit situation by 2013. The Spanish authorities should bring the general government deficit below 3 % of GDP

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

in a credible and sustainable manner by taking action in a medium-term framework. To this end, the Spanish authorities should: (a) implement the significant deficit reducing measures in 2010 planned in the draft 2010 Budget Law; (b) ensure an average annual fiscal effort of above 1.5 % of GDP over the period 2010-2013, which should also contribute to halting the rapid rise of the government gross debt ratio, which is forecast to breach the reference value; (c) specify 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.

The Council established the deadline of 2 June 2010 for the Spanish government to take effective action to implement the deficit reducing measures in 2010 planned in the draft 2010 Budget Law and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

5.2. Assessment of action taken

Spain's GDP recorded a contraction of 3.6% in 2009, slightly less than the outlook presented in the Commission services autumn 2009 forecast, which had projected GDP to decline by 3.7% in 2009. As for economic activity in 2010, GDP was assumed to decline again by 0.8% in the Commission services' autumn 2009 forecast, while in the spring forecast, the GDP prospects were revised to a growth rate of -0.4%. As regards 2011, GDP was projected to expand by 1% according to the Commission services' autumn 2009 forecast and by 0.8% according to the spring 2010 forecast. Overall, the macroeconomic backdrop against which fiscal developments have taken place is not substantially different from the one expected at the time the Council issued its recommendations.

The February 2010 update of the stability programme of Spain targeted a general government deficit at 9.8% of GDP for 2010. In the Commission services' spring 2010 forecast, the government deficit was also projected at 9.8% of GDP in 2010. On 12 May 2010, Spain announced a consolidation package, which was approved by parliament on 27 May 2010 and underpinned a downward revision of the 2010 and 2011 deficit targets. For 2010, the deficit target is reduced to 9.3% of GDP. This adds to efforts already taken, such as the discontinuation of temporary stimulus measures adopted for 2009 and some tax increases in 2010. The May consolidation measures are expected to entail a consolidation of 0.5% of GDP in 2010 and of 1.5% of GDP in 2011 (in cumulative terms), in comparison with the plans outlined in the February 2010 stability programme. The new measures are all made up of expenditure cuts, the most sizeable of which concern: government wages, with a cut by 5% in nominal wages on average as of mid 2010 and more for higher wages, and their freeze in 2011; a reduction of public investment; a freeze on pensions (except for the lowest pension categories); phasing-out of the tax allowance in the personal income tax for birth or adoption of a child; and cuts in transfers to regional and local governments.

Moreover, the government adopted on 28 May 2010 a ceiling for non-financial expenditure of the central government of slightly over 122 bn. euro, which implies a drop of 7.7% in expenditure in relation to the 2010 budget. This could result in a further reduction of government expenditure of around 1% of GDP. However, the individual measures to keep spending within the ceiling still need to be identified.

The structural balance in 2010 – i.e., the cyclically-adjusted balance net of one-off and other temporary measures, was expected to yield an improvement of 2 pps. of GDP in the February 2010 stability programme plans. According to the Commission services' spring 2010 forecast, the structural deficit could improve by over 1 pp. of GDP, although the announcement of the new wave of consolidation measures in mid-May implies that the improvement in the structural balance is now expected to be over 1½ pps. of GDP.

As for 2011, the February 2010 update of the stability programme of Spain targeted a government deficit of 7.5% of and projected a GDP growth of 1.8%, while the Commission services' spring 2010 forecast projected a government deficit of 8.8% of GDP in 2011 and an expansion of GDP of 0.8% in 2011. The difference in the growth scenarios between the Spanish authorities and the Commission entails a risk for the achievement of the budgetary target in 2011 and beyond. The May consolidation measures underpinned a downward revision of the 2011 deficit target to 6% of GDP, which is expected to reduce GDP growth to 1.3%. Nevertheless, the initial difference in the growth scenarios between the Spanish authorities and the Commission remains, and so the risk for the achievement of the new budgetary target. As a result, the deficit targets still need to be backed-up by measures as stressed in the Commission's services assessment of the 2010 update of the stability programme, in order for the new expenditure ceilings to be respected.

The 2010 update of the stability programme underpinned a deficit reduction with a number of consolidation measures that targeted on equal shares the expenditure and revenue sides. The restraint in government expenditure focused on areas such as compensation of employees, investment or intermediate consumption, whereas the additional tax revenue would come mainly from increases in VAT rates, excise taxes and the elimination of the 400-euro personal income tax credit. In comparison with the plans outlined in the stability programme, the additional consolidation measures announced on 12 May are planned to yield a deficit reduction by 1.5% of GDP: a 0.5% of GDP deficit reduction is due to measures already in place in 2010, with measures becoming effective in 2011 having an additional impact of 1% of GDP through expenditure cuts.

According to the latest update of the stability programme, the structural balance was expected to reflect an improvement of 1¾ pps. of GDP in 2011. In the light of the announcement of 12 May, the Commission estimates the improvement in the structural balance in 2011 to be slightly over 1¾ pps. of GDP in relation to 2010, after the additional measures announced in mid May. This overall outlook for fiscal consolidation in 2010 and 2011 compares with the call in the Council Recommendation under Article 126(7) TFEU for an average annual fiscal effort of 1½% of GDP over the period 2010-2013.

As for 2012 and 2013, the 2010 update of the stability programme targeted deficits of 5.3% and 3.0% of GDP respectively. The structural balance was projected to improve by an annual average of over 1½% of GDP in those two years. The deficit reduction was planned to be helped by a gradually accelerating GDP and the concomitant increase in tax revenue and would also reflect discretionary efforts, mainly to contain spending, including a reductions in compensation of employees, intermediate consumption and investment. However, the front loading of consolidation plans in mid May have made the targets for 2012 and 2013 of the stability programme somewhat outdated, and new deficit targets have been set at 4.4% and 3.0% of GDP in 2012 and 2013 respectively. Taking into account risks to these ambitious fiscal targets, further sizeable corrective efforts may be needed in order to attain these annual deficit targets up to the year 2013.

Regarding government gross debt, it is estimated to have reached 53.2% of GDP in 2009, significantly up from 39.7% in the year before. Apart from the sizeable increase in the deficit and the decline in GDP growth, a significant stock-flow adjustment reflecting mostly credit support operations also contributed to the rise in the debt ratio. According to the 2010 update of the stability programme, the debt ratio is projected to increase by 19 pps. over the programme period. This ratio is expected to reach 74.3% of GDP in 2012, mainly driven by continued high government deficits, followed by a slight decrease to 74.1% of GDP in 2013. The Commission services spring 2010 forecast projects the debt ratio at 64.9% of GDP in 2010 and at 72.5% of GDP in 2011, although the consolidation measures announced in May are expected to result in correspondingly lower debt levels.

5.3. Conclusions

On current information it appears that Spain has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, the Spanish authorities have taken measures that represent an annual fiscal effort of more than 1½% of GDP in both 2010 and 2011.

For the period beyond 2010, the Spanish authorities have outlined in some detail plans for a correction of the excessive deficit situation by 2013, as recommended by the Council, announcing a number of new measures in mid-May 2010 which entail an additional fiscal consolidation effort of 1% of GDP in 2011 to underpin the consolidation path. This brings total consolidation in both years to 1.5% of GDP. These measures explain the change in targets compared to the stability programme. However, as noted in the stability programme assessment, the consolidation effort for reaching the 2011 target, estimated at some 1¾ pp. of GDP, should be further specified as soon as possible in the context of the 2011 budget preparatory work. Part of this consolidation would be achieved by respecting the expenditure ceilings announced on 28 May 2010. As regards the outer years, additional efforts will be required for the debt ratio to embark on a downward path by the end of the correction period in 2013. Those efforts would have to be designed taking into account the possibility that the fiscal restraint takes a toll on economic growth over the short and medium term, before the benefits of a more sustainable public finances and a sounder macroeconomic setting materialise.

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

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013
Real GDP	COM	3.6	0.9	-3.6	-0.4	0.8	n.a.	n.a.
(% change)	SP		0.9	-3.6	-0.3	1.8	2.9	3.1
Output gap[1]	COM	1.7	0.8	-3.6	-4.6	-4.2	n.a.	n.a.
(% of potential GDP)	SP		0.6	-3.5	-4.4	-3.2	-1.6	-0.2
General government balance	COM	1.9	-4.1	-11.2	-9.8	-8.8	n.a.	n.a.
(% of GDP)	SP		-4.1	-11.4	-9.8	-7.5	-5.3	-3.0
	New targets[3]				-9.3	-6.0	n.a.	n.a.
Primary balance	COM	3.5	-2.5	-9.4	-7.6	-6.2	n.a.	n.a.
(% of GDP)	SP		-2.5	-9.6	-7.7	-4.9	-2.3	0.1
Cyclically-adjusted balance[1]	COM	1.2	-4.4	-9.6	-7.8	-7.0	n.a.	n.a.
(% of GDP)	SP		-4.3	-9.9	-7.9	-6.1	-4.6	-2.9
Structural balance[2]	COM	1.2	-4.1	-8.9	-7.8	-7.0	n.a.	n.a.
(% of GDP)	SP		-4.3	-9.9	-7.9	-6.1	-4.6	-2.9
Government gross debt	COM	36.2	39.7	53.2	64.9	72.5	n.a.	n.a.
(% of GDP)	SP		39.7	55.2	65.9	71.9	74.3	74.1

Note:
[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] Cyclically-adjusted balance excluding one-off and other temporary measures.
[3] New targets for the government balance for 2010 and 2011 in accordance with the announced consolidation measures on 12 May 2010
Source: Commission services' 2010 spring forecast (COM) and March 2010 stability programme update (SP)

6. FRANCE

6.1. Excessive deficit procedure and most recent recommendations

On 27 April 2009, the Council decided that an excessive deficit existed in France in accordance with Article 104(6) of the Treaty establishing the European Community (TEC). The most recent Council Recommendation under Article 126(7) of the Treaty on the Functioning of the European Union (TFEU) was adopted on 2 December 2009[13].

The Council recommended the French authorities to put an end to the excessive deficit situation by 2013. The French authorities should 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 French authorities should (a) implement the deficit-reducing measures in 2010 as planned in the government proposal for the budget law for 2010 while avoiding a further deterioration of public finances, and implement and strengthen the fiscal effort from 2011 onwards above the consolidation measures already planned; (b) ensure an average annual fiscal effort of above 1% of GDP over the period 2010-2013, 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; (c) specify 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.

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

In addition, the French authorities should seize opportunities beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the reference value.

The Council established the deadline of 2 June 2010 for the French government to take effective action to implement the fiscal measures in 2010 as planned in the government proposal for the budget law for 2010 and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009.

6.2. Assessment of action taken

In 2009, GDP contracted by 2.6%, according to the first official annual estimate, somewhat more than forecast in the Commission services' autumn 2009 forecast (2.2%). The country came out of the recession in mid-2009 and, according to the Commission services' 2010 spring forecast, economic activity is set to continue to recover in the course of 2010 (1.3%) and 2011 (1.5%), broadly unchanged with respect to the autumn 2009 forecast. This modest recovery will translate into a gradually closing output gap.

The 2009 deficit came out at 7.5% of GDP thanks to better-than-expected revenue, compared to an anticipated 8.2% of GDP. This led to a lowering of the official deficit projection for 2010 by 0.5 pp. to 8.0% of GDP, as also shown in the spring 2010 forecast. The new deficit projection takes into account the impact of the decision to suspend the environmental tax and the measures linked to the '*grand emprunt*' (totalling 0.2% of GDP).

The 2010 structural deficit is forecast to be unchanged from 2009, at 6.2% of GDP. The balance of discretionary measures is broadly neutral. Recovery measures of 1.1% of GDP in 2009 are partially phased out in 2010, and reduced to around 0.3% of GDP; in addition, some further consolidation measures represent around 0.1% of GDP. Thus France implemented the deficit-reducing measures in 2010 as planned, and mostly related to the partial withdrawal of the recovery plan. These savings are fully offset by measures introduced in the context of the '*grand emprunt*' (around 0.1% of GDP) as well as new stimulus measures amounting to 0.7% of GDP[14]; 0.4% of GDP of the latter are a one-off decrease of revenue linked to the reform of the local business tax, therefore not affecting the structural balance. However, there are higher interest expenditure and the lagged effect of the crisis on social benefits of the same magnitude. In all, the fiscal stance in 2010 remains neutral and falls short of the fiscal effort of ½% of GDP originally planned and the "above 1% of GDP" recommended for the average annual structural adjustment over 2010 – 2013 as foreseen in the Council recommendation.

As regards 2011, the French authorities planned in the latest stability programme that the general government deficit would decrease to 6% of GDP. The recovery package will be completely withdrawn, with a deficit-decreasing impact of around 0.3% of GDP; moreover, the transitory budgetary impact of 0.4% of GDP of the reform of the local business tax will be phased out. These measures are estimated to more than offset the budgetary impact linked to the '*grand emprunt*' (around 0.1% of GDP). In 2011–2013, the improvement in the deficit relies on measures aimed at curbing expenditure growth at all sub-government levels. The government announced that it would freeze all expenditure at the central government level except for interest and pensions for civil servants. The budgetary impact of existing tax

[14] This includes the reform of the local business tax (0.6% of GDP) and the decrease in the VAT rate for the catering sector (0.1% of GDP).

exemptions would be reduced by around 0.1% of GDP each year starting in 2011. Finally, a legislative proposal for a further pension reform is planned for the summer. However, as concluded by the Council in its opinion on the latest update of the stability programme, the adjustment path presented in the programme is also based on a markedly favourable macro scenario for 2011-2013 combined with an average annual structural adjustment that is somewhat below the adjustment recommended of above 1% of GDP. The medium-term budgetary projections are therefore subject to substantial downside risks and the fiscal consolidation may need to be strengthened accordingly and measures sufficiently specified to ensure a correction of the excessive deficit by 2013, as recommended by the Council.

Regarding the debt-to-GDP ratio, the latest update of the stability programme anticipates that it would reach the level of about 87% in 2013, up from an anticipated 77.4% in 2009. In view of the substantial risks to the budgetary targets, the evolution of the debt ratio is likely to be less favourable than projected in the programme. The Commission services' 2010 spring forecast projects the ratio to attain 88.6% in 2011.

France intends to make improvements in the area of fiscal governance. Following recommendations made at the second conference on public finances, the government decided to curb the evolution of healthcare spending and to better control local government expenditure notably by freezing transfers to it. Moreover, it announced its intention to set up rules notably compelling each newly appointed government to set out a five-year consolidation path. Details in this respect are expected to be announced in the coming months.

6.3. Conclusions

On current information it appears that France has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, the French authorities have broadly implemented the deficit-reducing measures in 2010 as planned, notably the partial withdrawal of the recovery plan. The deficit target for 2010 has been revised down by 0.5% of GDP compared to the budget target, taking into account a better outcome for 2009.

For the period after 2010 the French authorities have outlined in some detail the consolidation strategy necessary to progress towards the correction of the excessive deficit by 2013, the deadline recommended by the Council. However, measures backing the consolidation strategy need to be further specified. In addition, given the risks related to the growth scenario and assumptions as regards tax elasticities, the consolidation strategy may have to be strengthened and further consolidation measures backing this strategy may have to be taken to achieve a correction of the excessive deficit by the deadline and to ensure that the debt ratio embarks on a downward path by the end of the correction period. In view of the above, it would be important for France to take action to further specify consolidation measures for the coming years in order to ensure a timely correction of the excessive deficit.

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

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013
Real GDP (% change)	COM	2.3	0.4*	-2.2*	1.3	1.5	n.a.	n.a.
	SP	n.a.	0.4	-2.25	1.4	2.5	2.5	2.5
Output gap[1] (% of potential GDP)	COM	1.9	0.8	-2.7	-2.7	-2.3	n.a.	n.a.
	SP	n.a.	0.8	-2.9	-2.9	-2.1	-1.2	-0.4
General government balance (% of GDP)	COM	-2.7	-3.3	-7.5	-8.0	-7.4	n.a.	n.a.
	SP	n.a.	-3.4	-7.9	-8.2	-6.0	-4.6	-3.0
Primary balance (% of GDP)	COM	0.0	-0.5	-5.2	-5.4	-4.5	n.a.	n.a.
	SP	n.a.	-0.6	-5.4	-5.5	-3.2	-1.7	-0.1
Cyclically-adjusted balance[1] (% of GDP)	COM	-3.7	-3.7	-6.2	-6.6	-6.2	n.a.	n.a.
	SP	n.a.	-3.8	-6.5	-6.8	-4.9	-4.0	-2.8
Structural balance[2] (% of GDP)	COM	-3.8	-3.8	-6.2	-6.2	-6.2	n.a.	n.a.
	SP	n.a.	-3.8	-6.5	-6.8	-4.9	-4.0	-2.8
Government gross debt (% of GDP)	COM	63.8	67.5	77.6*	83.6	88.6	n.a.	n.a.
	SP	n.a.	67.4	77.4	83.2	86.1	87.1	86.6

Note:

*According to the national accounts released on 12th May 2010 by INSEE GDP growth has been revised to 0.2% and -2.6% for 2008 and 2009, respectively. At the same moment Government gross debt has been revised to 78.1% of GDP for 2009.

[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] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Commission services' 2010 spring forecast (COM) and February 2010 stability programme update (SP)

7. ITALY

7.1. Excessive deficit procedure and most recent recommendations

On 2 December 2009, the Council decided that an excessive deficit existed in Italy in accordance with Article 126(6) of the Treaty on the Functioning of the European Union (TFEU) and addressed recommendations to Italy in accordance with Article 126(7) with a view to bringing an end to the situation of an excessive government deficit[15].

The Council recommended Italy to put an end to the present excessive deficit situation by 2012. The Italian authorities should 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 Italian authorities should: (a) implement the budgetary measures in 2010 as planned in the three-year fiscal package for 2009-2011 approved in summer 2008 and confirmed in the Economic and Financial Planning Document (EFPD) 2010-2013; (b) ensure an average annual fiscal effort of at least 0.5 percentage points of GDP over the period 2010-2012, which should also contribute to bringing the government gross debt ratio back on a declining path that approaches the 60% of GDP reference value at a satisfactory pace by restoring an adequate level of the primary surplus; and (c) specify the measures that are necessary to achieve the correction of the excessive deficit by 2012, cyclical conditions

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

permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

In addition, the Italian authorities should seize any opportunities beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio towards the 60% of GDP reference value.

The Council established the deadline of 2 June 2010 for the Italian government to take effective action to implement the fiscal measures in 2010 as planned and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

7.2. Assessment of action taken

The near-term outlook for the Italian economy has not changed significantly since the Commission services' autumn 2009 forecast, which underpinned the Council recommendation. Real GDP contracted by 1.3% in 2008, slightly more than estimated earlier by the statistical office (-1%), and by 5% in 2009 (-4.7% in the autumn 2009 forecast). The Commission services' spring 2010 forecast projects output to grow by 0.8% in 2010, marginally faster than projected in autumn 2009 (0.7%), while the growth projection for 2011 remains unchanged at 1.4%.

After reaching 5.3% of GDP in 2009, the deficit ratio is targeted to decrease slightly in 2010, to 5% of GDP. This target was initially set in the July 2009 EFPD, setting out the budgetary strategy for 2010-2013, and was most recently confirmed in the Combined Report on the Economy and Public Finances (RUEF)[16] published on 6 May 2010. The measures underlying the 2010 deficit target are those already adopted in the summer 2008 fiscal package for 2009-2011, aimed at restraining expenditure and estimated according to the authorities to reduce the 2010 deficit in cumulative terms by around 1 pp. of GDP compared to an unchanged legislation scenario (half of which represents the effect of the measures for 2009). Some additional expansionary measures were adopted with the budget for 2010, directed at supporting low-income workers and ensuring the funding of additional health and social expenditure and of military missions abroad. These additional measures account for a relatively small share of GDP (0.4%) and are, according to official estimates, fully financed, mainly through the one-off revenues from the extraordinary tax on illegally expatriated assets (scudo fiscale) recorded in 2009 and used in the budget for 2010 to postpone from 2009 to 2010 the collection of some income taxes. The budgetary strategy for 2010 can be regarded as broadly in line with the Council recommendations even though the additional measures in the budget imply some deviation. The Commission services' spring 2010 forecast projects a slightly higher deficit ratio in 2010 (5.3%) relative to the RUEF, mainly reflecting a less favourable projection for tax elasticities. The forecast points to an improvement in the structural deficit (the cyclically-adjusted deficit net of one-off and other temporary measures) by around ¼ pp. of GDP in 2010, slightly short of the average annual fiscal effort of at least 0.5% of GDP over the period 2010-2012 as recommended under Article 126(7). This compares with the ½ pp. of GDP structural adjustment projected in the stability programme and RUEF.

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[16] Relazione Unificata sull'Economia e la Finanza pubblica (RUEF), available (in Italian only) at: http://www.mef.gov.it/doc-finanza-pubblica/dfp.ruef.asp

For the period after 2010, the authorities target a gradual reduction of the deficit to below 3% of GDP by 2012, the correction deadline set by the Council. To achieve the deficit target of 3.9% of GDP in 2011, the RUEF envisages the additional consolidation effort beyond that already adopted with the fiscal package for 2009-2011 to be doubled compared to what was planned in the stability programme (0.8% of GDP as against 0.4%), mainly because of a downward revision of GDP growth in the RUEF. In 2012, the further additional consolidation effort remains unchanged in the RUEF (0.8% of GDP) as the underlying growth projection is the same as in the stability programme. On 25 May 2010, the government adopted a decree law specifying the measures that underpin the additional consolidation efforts for 2011-2012, which fall mainly on current expenditure. The package foresees cuts in expenditure amounting to around 0.5% of GDP in 2011 and 1% in 2012 relative to the trend scenario based on unchanged legislation. Half of these cuts will be borne by the local authorities, as transfers from the central government will be reduced. The rest includes restraint in wages and recruitment throughout the public sector, cuts to ministerial expenditure and the postponement by some months of access to retirement for those meeting the age/seniority eligibility conditions. On the revenue side, the fight against tax evasion will be stepped up and is expected to yield higher revenues of around 0.1% of GDP in 2011 and 0.5% in 2012.

The downward revision of growth assumptions for 2010-2011 underlying the government's latest projections and the specification of the additional consolidation measures for 2011-2012 address some of the risks to Italy’s medium-term budgetary strategy that were highlighted in the Council Opinion of 26 April 2010 on the stability programme. However, deficit outcomes in the entire period could still be worse than targeted, in particular in the light of the favourable assumptions on tax elasticities in the government projections for 2010 and a track record of expenditure overruns.

The Council opinion highlighted that the evolution of the gross government debt-to-GDP ratio could well be less favourable than the 114.6% projected in the stability programme in 2012. The RUEF contains an upward revision of the debt projections over the period 2010-2012, due to: (i) a higher 2009 starting position; (ii) lower nominal GDP growth; and (iii) less favourable stock-flow adjustment developments. The RUEF projects a decline in the debt ratio as from 2012, to 117.2% of GDP, one year later than the stability programme. In the Commission services' spring 2010 forecast, based on a no-policy-change assumption, the debt ratio was expected to increase to around 119% in 2011.

7.3. Conclusions

On current information it appears that Italy has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, the consolidation measures for 2010, taken in the context of the summer 2008 package for the period 2009-2011 and, according to the authorities, reducing the 2010 trend deficit by around 0.5% of GDP, are being implemented broadly as recommended by the Council and the 5% of GDP deficit target for 2010 has been confirmed. For the period after 2010, the Italian authorities have spelled out the budgetary strategy to reduce the deficit below 3% of GDP by 2012, the deadline set by the Council, based on an additional consolidation effort of 0.8% of GDP in 2011 and again in 2012. The Commission welcomes the adoption by the Italian government of a decree law specifying the measures that underpin these efforts. In order to achieve the correction of the excessive deficit by the deadline, it will be important to ensure a strict implementation of the planned expenditure restraint and address possible tax revenue shortfalls, also to ensure that the debt ratio embarks on a downward path by the end of the correction period.

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

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012
Real GDP (% change)	COM	1.5	-1.3	-5.0	0.8	1.4	n.a.
	RUEF	1.5	-1.3	-5.0	1.0	1.5	2.0
	SP	1.6	-1.0	-4.8	1.1	2.0	2.0
Output gap[1] (% of potential GDP)	COM	3.0	1.2	-3.9	-3.4	-2.6	n.a.
	RUEF	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	SP	2.7	1.1	-4.0	-3.5	-2.5	-1.6
General government balance (% of GDP)	COM	-1.5	-2.7	-5.3	-5.3	-5.0	n.a.
	RUEF	-1.5	-2.7	-5.3	-5.0	-3.9	-2.7
	SP	-1.5	-2.7	-5.3	-5.0	-3.9	-2.7
Primary balance (% of GDP)	COM	3.5	2.5	-0.6	-0.7	-0.2	n.a.
	RUEF	3.5	2.5	-0.6	-0.4	1.0	2.5
	SP	3.5	2.4	-0.5	-0.1	1.3	2.7
Cyclically-adjusted balance[1] (% of GDP)	COM	-3.0	-3.3	-3.3	-3.6	-3.7	n.a.
	RUEF	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	SP	-2.9	-3.3	-3.2	-3.2	-2.7	-1.9
Structural balance[2] (% of GDP)	COM	-3.2	-3.5	-4.0	-3.7	-3.6	n.a.
	RUEF	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	SP	-3.0	-3.5	-3.8	-3.3	-2.7	-1.9
Government gross debt (% of GDP)	COM	103.5	106.1	115.8	118.2	118.9	n.a.
	RUEF	103.5	106.1	115.8	118.4	118.7	117.2
	SP	103.5	105.8	115.1	116.9	116.5	114.6

Notes:

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

[2] Cyclically-adjusted balance excluding one-off and other temporary measures. In the Commission services' spring 2010 forecast and stability programme, one-off and other temporary measures are 0.2% of GDP in 2007 and 2008, 0.6% in 2009 and 0.1% in 2010, all deficit-reducing.

Source: Commission services' 2010 spring forecast (COM); January 2010 stability programme update (SP); and May 2010 Combined Report on the Economy and Public Finances (RUEF).

8. THE NETHERLANDS

8.1. Excessive deficit procedure and most recent recommendations

On 2 December 2009, the Council decided that an excessive deficit existed in the Netherlands in accordance with Article 126(6) of the Treaty on the Functioning of the European Union (TFEU) and addressed recommendations to the Netherlands in accordance with Article 126(7) with a view to bringing an end to the situation of an excessive government deficit[17].

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

The Council recommended the Dutch authorities to implement the fiscal measures in 2010 as envisaged and, starting consolidation in 2011, put an end to the present excessive deficit by 2013.

The Dutch authorities should 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 Dutch authorities should (a) ensure an average annual fiscal effort of ¾% of GDP over the period 2011-2013, which should also contribute to halting the rapid rise of the government gross debt ratio, which is forecast to breach the reference value; (b) specify 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.

The Council established the deadline of 2 June 2010 for the Netherlands to take effective action to implement the fiscal measures in 2010 as envisaged and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

8.2. Assessment of action taken

The global economic and financial crisis led to a contraction of Dutch GDP by 4% in 2009. The rebound of economic growth in the second half of 2009, mainly driven by the improvement in global demand, explains why the Commission services' spring 2010 forecast projects economic activity for 2010 and 2011 to be positive at 1.3% and 1.8%, respectively. The output gap is expected to gradually diminish over the forecast horizon. These latest projections indicate that economic conditions have improved significantly since the Commission services' autumn 2009 forecast, on which the Council recommendation of 2 December 2009 was based. This forecast expected a contraction of real GDP of -4.5% of GDP in 2009, followed by positive real GDP growth of 0.3% of GDP in 2010 and 1.6% of GDP in 2011.

Regarding 2010, the authorities are implementing the fiscal measures that were envisaged in the 2010 budget as recommended by the Council. This notably concerns the continuation of the stimulus package which in 2010 amounts to approximately 1% of GDP, somewhat higher than 2009. The measures are evenly spread between the revenue and the expenditure side.

Despite the fact that fiscal measures are implemented as envisaged in the budget, according to the authorities' spring memorandum, published on 28 May 2010, the budget deficit for 2010 is expected to come out at 6.6% of GDP. This is 0.3% of GDP higher than foreseen in the 2010 budget. The deficit does not appear to benefit from the improved economic outlook. In the 2010 budget, real GDP growth had been projected to come out at zero growth and in the autumn forecast relevant for the Council recommendation it had been foreseen at 0.3%, whereas the authorities now foresee real GDP growth of 1½% for 2010. Based on standard elasticities, this could have lowered the budget deficit by at least ½% of GDP. However, the improved outlook is particularly concentrated on the tax-poor external side. Furthermore, there is a negative base effect, as the 2009 budget deficit came out at 5.3% of GDP, which was 0.5% of GDP worse than foreseen in the 2010 budget. Finally, the budget is adversely affected by a recently announced reclassification of a capital injection in a financial institution amounting to 0.2% of GDP, which could not be incorporated in the spring forecast.

The 2010 structural deficit is expected to increase from 3½% of GDP in 2009 to 4¾% of GDP in 2010 according to the Commission services' spring 2010 forecast. In these uncertain times the cyclically-adjusted and structural balances need to be interpreted with caution. The deterioration of the structural balance in 2010 can partly be explained by higher interest expenditure linked to higher debt and decreasing gas revenues, but most importantly by lagged effects, notably stemming from increasing unemployment, which leads to higher expenditure and lower tax revenues than would be suggested when using standard elasticities.

The Dutch government indicated in their programme that consolidation would start in 2011, which should result in an improvement of the general government balance of around 1¼% of GDP, leading to a deficit of 5.0% of GDP. This is broadly in line with the Commission services' spring 2010 forecast, which expects a deficit of 5.1% of GDP in 2011. It also corresponds to an improvement of the structural balance of 0.9% of GDP, which is slightly above the required average annual fiscal effort of ¾% for the period 2011-2013 as recommended by the Council. The budgetary improvement comes from cyclical conditions (above potential real GDP growth at 1.8% for 2011), a budgetary consolidation consisting of the (partial) withdrawal of the stimulus package amounting to approximately ½% of GDP, and an additional consolidation package amounting to ¼% of GDP, mainly concentrated on the expenditure side[18]. For 2012, the ½% of GDP improvement of the balance (to 4.5% of GDP) as presented in the programme seems to be essentially based on favourable assumptions and is below the required average annual fiscal effort of ¾%. Moreover, the programme did not contain information on 2013. In a letter sent to the Commission on 1 June 2010 the authorities refer to a deficit of 3.0% of GDP for 2013, which stems from the medium-term projections of the Netherlands Bureau of Economic Policy Analysis (CPB), but is not underpinned by specified measures. Given the lack of measures for 2012 and 2013, additional consolidation measures will be needed to bring the deficit below 3% of GDP by 2013. The Fundamental Budget Review (FBR), which presented structural reform and saving options, could serve as a basis to further specify the measures supporting the consolidation from 2011 and to strengthen the consolidation effort.

The debt level increased sharply from 45.5% of GDP in 2007 to 60.9% of GDP in 2009, mainly as the result of measures to stabilise the financial sector (amounting to around 10% of GDP at the end of 2009) and the high deficit in 2009. According to the programme, debt is on a further increasing trend, reaching 69.6% of GDP in 2011 and 72.5% of GDP in 2012. The evolution of the debt could be less favourable than projected in the programme, in view of the risk of higher-than-targeted deficits and from sizeable guarantees to the financial sector. The spring forecast projects the debt to increase to 69.6% of GDP in 2011.

8.3. Conclusions

On current information it appears that the Netherlands has taken action representing adequate progress towards the implementation of the Council Recommendations under the Article 126(7) TFEU of 2 December 2009. In particular, the Netherlands is implementing the fiscal measures in 2010 as envisaged in the 2010 budget.

The Dutch authorities have outlined in some detail the consolidation strategy that is necessary to progress towards the correction of the excessive deficit by 2013, the deadline recommended by the Council. In particular with respect to 2011, there is a fully specified

[18] Mainly relating to local governments, transport infrastructure and education.

consolidation strategy leading to a fiscal effort of ¾% of GDP, which is in line with the annual fiscal effort as requested in the Council Recommendation. However, more information on the adjustment path and the broad measures underpinning the envisaged consolidation in the outer years will be needed. To this end, the concluded fundamental budget review could serve as a basis for further specifying the measures supporting the consolidation from 2011 onwards and strengthening the consolidation effort to secure the required average annual fiscal effort for the period 2011-2013 and to bring the deficit below 3% of GDP by 2013 and to ensure that the debt ratio embarks on a downward path by the end of the correction period.

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

Comparison of key macroeconomic and budgetary projections

		2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Real GDP (% change)	COM	3.6	2.0	-4.0	1.3	1.8	n.a.	n.a.
	SP	3.6	2.0	-4.0	1.5	2	2	n.a
Output gap[1] (% of potential GDP)	COM	2.2	2.3	-3.0	-2.6	-2.0	n.a.	n.a.
	SP	2.2	2.6	-2.7	-2.3	-1.9	-1.8	n.a
General government balance (% of GDP)	COM	0.2	0.7	-5.3	-6.3	-5.1	n.a.	n.a.
	SP	0.2	0.7	-4.7	-6.1	-5.0	-4.5	n.a
Primary balance (% of GDP)	COM	2.4	2.8	-3.0	-4.0	-2.8	n.a.	n.a.
	SP	2.4	2.8	-2.5	-3.7	-2.6	-2.0	n.a
Cyclically-adjusted balance[1] (% of GDP)	COM	-1.0	-0.5	-3.6	-4.9	-4.0	n.a.	n.a.
	SP	-1.0	-0.8	-3.4	-4.8	-3.9	-3.5	n.a
Structural balance[2] (% of GDP)	COM	-1.0	-0.5	-3.6	-4.9	-4.0	n.a.	n.a.
	SP	-1.0	-0.6	-3.8	-4.8	-3.9	-3.5	n.a
Government gross debt (% of GDP)	COM	45.5	58.2	60.9	66.3	69.6	n.a.	n.a.
	SP	45.5	58.2	62.3	67.2	69.6	72.5	n.a

Note:

[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] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Commission services' 2010 spring forecast (COM) and January 2010 stability programme update (SP)

9. AUSTRIA

9.1. Excessive deficit procedure and most recent recommendations

On 2 December 2009, the Council decided that an excessive deficit existed in Austria in accordance with Article 126(6) of the Treaty on the Functioning of the European Union (TFEU) and addressed recommendations to Austria in accordance with Article 126(7) with a view to bringing an end to the situation of an excessive government deficit[19].

[19] All EDP related documents for Austria can be found at the following website: http://ec.europa.eu/economy_finance/sgp/deficit/countries/index_en.htm

The Council recommended the Austrian authorities to implement the fiscal measures in 2010 as envisaged and, starting consolidation in 2011, put an end to the present excessive deficit situation by 2013. The Austrian authorities should 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 Austrian authorities should: (a) ensure an average annual fiscal effort of ¾ % of GDP over the period 2011-2013, 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; (b) specify 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.

In addition, the Austrian authorities should seize opportunities beyond the fiscal effort including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the reference value.

The Council established the deadline of 2 June 2010 for the Austrian government to take effective action to implement the fiscal measures in 2010 as planned and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action takes into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

9.2. Assessment of action taken

The Commission services' spring 2010 forecast foresees that Austria's GDP will grow in real terms by 1.3% and 1.6% in 2010 and 2011 respectively. The negative output gap is projected to stay unchanged in 2010 and edge down somewhat the year after. The gradual recovery is expected to be led first by net exports. Subsequently, domestic demand is projected to take over as the main driver of growth on the back of gross fixed capital formation returning to positive growth rates. In comparison to the Commission services' autumn 2009 forecast, the spring 2010 forecast constitutes a slight upward revision by 0.1-0.2 pps. in both years.

According both to the latest government projections in the January 2010 update of the Stability Programme and the Commission services' spring 2010 forecast, the general government deficit is set to widen by around 1.3 pps. and reach 4.7% of GDP in 2010. The deterioration is due to negative composition effects with growth drivers shifting towards net exports, the free operation of automatic stabilisers and some discretionary measures implemented in line with the EERP. In particular, parts of the 2009 tax reform, namely relief for families with children and tax cuts for the self-employed, came into force only in 2010 and are expected to burden the budget by about ¼% of GDP. The accelerated depreciation provision, adopted in January 2009, will also weigh somewhat on the budget in 2010.

The main goal of Austria's medium-term budgetary strategy, as presented in the latest update of the stability programme, is to reduce the general government deficit to below 3% of GDP by 2013, in line with the Council Recommendation of 2 December 2009. However, the targets outlined in the programme were not underpinned by appropriate measures. In particular for 2011, the programme foresees a deficit reduction of 0.7 pps., while the Commission services forecast only a slight consolidation (0.1 pps.) as the deficit-increasing and the deficit-decreasing measures, spelled out in the update, almost offset each other. On the one hand, the budget will be burdened by, among others, additional revenue shortfall following from the

2009 tax reform as well as the cost of the prolongation of the access to a special early retirement channel for workers with very long insurance periods *(Hacklerregelung)*. On the other hand, a small decrease in health-care expenditure was agreed on by the federal government and the public health funds. On top of that, expenditure on labour market relief will be reduced as the short-time work scheme is being phased out.

On 19 May 2010, the Austrian Parliament adopted the federal expenditure framework law *(Bundesfinanzrahmengesetz)*, as also explained in the addendum to the January 2010 update of the stability programme submitted on 1 June. The new law establishes fixed ceilings for about 80% of total expenditure for the period 2011-2014. For 2011, it foresees a drop in the federal budget expenditure limit by around 1.7 billion euro (0.6% of GDP). For the remaining years, it sets nominally growing spending limits, but small enough to ensure a decreasing federal expenditure-to-GDP ratio. However, it is still unclear how these spending limits will be translated into concrete measures. The 2011-2014 federal expenditure law was based on the agreement between the government coalition partners of early March 2010 as to how to bring the general government deficit below 3% of GDP by 2013. Next to the decision about the extent of the consolidation on the expenditure side, now enshrined in the above-described law, it was agreed that 40% of the needed consolidation effort would fall on the revenue side. It has not been decided yet where the additional revenue would come from, though. Some of the currently discussed sources are: changes to the rules governing the capital income tax and the tax on foundations, introduction of a special bank levy and financial transactions tax, a rise in the petrol tax, and an increase in the tax rate for high-income earners. The lack of details concerning the consolidation measures both on expenditure and revenue side puts at risk the achievement of the budgetary targets.

According to the January 2010 update of the stability programme, government gross debt, which amounted to 66.5% of GDP in 2009, is projected to grow continuously in the medium-term, reaching over 74% of GDP in 2013. The evolution of the debt ratio is subject to risks stemming, in particular, from uncertainties surrounding the cost of future functioning of the country's fifth largest bank, Hypo Alpe Adria (nationalised in December 2008) and the State guarantees issued for the debt of the Austrian highway authority (ASFINAG) and Austrian Federal Railways (ÖBB). The Commission services spring 2010 forecast foresees the debt ratio of almost 73% of GDP in 2011, which is slightly higher than the projection in the stability programme, due to the difference in the deficit forecast for that year.

9.3. Conclusions

On current information it appears that Austria has taken action representing adequate progress towards the implementation of the Council Recommendations under the Article 126(7) TFEU of 2 December 2009. In particular, the Austrian authorities have implemented the fiscal stimulus measures as planned in 2010, including relief for families with children and tax cuts for the self-employed.

The Austrian authorities have outlined in some detail a medium-term budgetary strategy to correct the excessive deficit by 2013. For the years 2011-2014, the authorities have set spending limits for the main parts of the federal budget. However, in order to correct the excessive deficit by 2013 and to ensure that the debt ratio embarks on a downward path by the end of the correction period, the spending limits need to be translated into concrete measures and details concerning the consolidation on the revenue side need to be agreed on by the government coalition partners.

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

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013
Real GDP (% change)	COM	3.5	2.0	-3.6	1.3	1.6	n.a.	n.a.
	SP	3.1	2.0	-3.4	1.5	1.5	1.9	2.0
Output gap[1] (% of potential GDP)	COM	2.6	2.7	-2.3	-2.3	-2.1	n.a.	n.a.
	SP	2.5	2.8	-1.8	-1.6	-1.5	-1.3	-1.0
General government balance (% of GDP)	COM	-0.4	-0.4	-3.4	-4.7	-4.6	n.a.	n.a.
	SP	-0.5	-0.4	-3.5	-4.7	-4.0	-3.3	-2.7
Primary balance (% of GDP)	COM	2.3	2.1	-0.7	-1.8	-1.7	n.a.	n.a.
	SP	2.3	2.2	-0.7	-1.8	-1.2	-0.4	0.2
Cyclically-adjusted balance[1] (% of GDP)	COM	-1.6	-1.7	-2.4	-3.6	-3.6	n.a.	n.a.
	SP	-1.7	-1.7	-2.7	-3.9	-3.3	-2.7	-2.2
Structural balance[2] (% of GDP)	COM	-1.6	-1.7	-2.4	-3.6	-3.6	n.a.	n.a.
	SP	-1.7	-1.7	-2.7	-3.9	-3.3	-2.7	-2.2
Government gross debt (% of GDP)	COM	59.5	62.6	66.5	70.2	72.9	n.a.	n.a.
	SP	59.4	62.6	66.5	70.2	72.6	73.8	74.3

Note:

[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] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Commission services' 2010 spring forecast (COM) and January 2010 stability programme update (SP)

10. PORTUGAL

10.1. Excessive deficit procedure and most recent recommendations

On 2 December 2009, the Council decided that an excessive deficit existed in Portugal in accordance with Article 126(6) of the Treaty on the Functioning of the European Union (TFEU) and addressed recommendations to Portugal in accordance with Article 126(7) with a view to bringing an end to the situation of an excessive government deficit[20].

The Council recommended Portugal to put an end to the present excessive deficit situation by 2013. The Portuguese authorities should bring the general government deficit below 3 % of GDP in a credible and sustainable manner by taking action in a medium-term framework. To this end, the Portuguese authorities should: (a) implement the consolidation strategy envisaged in the January 2009 update of the Stability Programme; (b) ensure an average annual fiscal effort of 1¼ % of GDP over the period 2010-2013, 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; (c) specify the measures that are necessary to achieve the correction of the excessive deficit by

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

2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

In addition, the Portuguese authorities should seize opportunities beyond the fiscal effort, including from better economic conditions, to accelerate the reduction of the gross debt ratio back towards the reference value. To limit risks to the adjustment, Portugal would benefit from strengthening the enforceable nature of its medium-term budgetary framework as well as from continuing to improve the monitoring of the budget execution throughout the year.

The Council established the deadline of 2 June 2010 for the Portuguese government to take effective action necessary to implement the consolidation envisaged in the January 2009 update of the Stability Programme and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

10.2. Assessment of action taken

Portugal's GDP contracted by 2.7% in 2009, slightly less than the outlook presented in the Commission services' autumn 2009 forecast, which had projected GDP to decline by 2.9% in 2009. As for economic activity in 2010, real GDP was assumed to grow again by 0.3% in the Commission services' autumn 2009 forecast, while in the Commission services' spring 2010 forecast, the GDP growth prospects were revised upwards to a rate of 0.5%. Concerning 2011, GDP was projected to expand by 1% according to the Commission services' autumn 2009 forecast and by 0.7% according to the spring 2010 forecast. Overall, the macroeconomic backdrop against which fiscal developments have taken place is not substantially different from the one expected at the time the Council issued its recommendations.

Fiscal developments in 2009 were subject to a combination of adverse forces: the severity of the recession with a much stronger-than-expected impact on fiscal revenue, the operation of automatic stabilisers, and a discretionary fiscal expansion, part of it in the context of the European Economic Recovery Plan, coupled with an acceleration in underlying spending. In all, the general government deficit reached 9.4% of GDP in 2009. That compares with a deficit projection of 8% of GDP in the Commission services' autumn 2009 forecast and with a deficit target of 5.9% of GDP included in the EDP notification of late September 2009, with the slippage owed to lower-than-expected revenue as all categories of tax and non-tax proceeds declined sharply over the entire year of 2009, whereas the observed level of expenditure was broadly in line with the autumn forecast projections. In all, the 2009 deficit outturn was much worse than expected at the time the Council issued its recommendations under Article 126(7) TFEU. Thus, the fiscal efforts needed in order to achieve the Council's overarching objective of a correction of the excessive deficit situation by 2013 are larger than previously assumed.

The March 2010 update of the stability programme of Portugal targeted a general government deficit at 8.3% of GDP for 2010, under the assumption of real GDP growth of 0.7%. In the Commission services' spring 2010 forecast, the government deficit was projected at 8.5% of GDP in 2010, with the GDP growth being expected to be at 0.5%, i.e. slightly above the official target prevailing at that time.

On 8 May 2010, Portugal announced a revised target of 7.3% of GDP for the 2010 deficit, 2.1 pps. below the 2009 deficit outturn. The revision of the deficit target for 2010 and 2011 was supported by consolidation measures announced by the Portuguese authorities on 13 May. These measures, discussed in more detail in Annex 2, are assumed to yield a deficit reduction of 1.2% of GDP in 2010 in comparison with the plans in the March 2010 stability programme (a small part of those measures is the frontloading into 2010 of initiatives planned in the programme for 2011, which had already been included in the Commission services' forecast for 2010). The revenue and the expenditure sides are set to contribute on equal parts to the consolidation effort. They add to some efforts already taken, such as the discontinuation of temporary stimulus measures adopted for 2009 and some reining in of expenditure in 2010, notably by a nominal freeze in government wages for the current year[21].

The March 2010 stability programme aimed at an improvement in the structural balance in 2010 of just over ¾ pp. of GDP. According to the Commission services' spring 2010 forecast, the structural deficit could improve by some ½ pp. of GDP on account of a slightly more cautious scenario for the nominal deficit. The announcement of the new wave of consolidation measures on 13 May made those two earlier outlooks outdated: the improvement in the structural balance is now expected to be larger than before, possibly coming close to 1½ pps of GDP. A broadly similar conclusion is warranted when looking at the sum of the possible deficit-reducing effect of the different consolidation measures for 2010 put forward by Portugal up to this date.

As for 2011, the March 2010 update of the stability programme of Portugal targeted a government deficit of 6.6% of GDP, under an assumed GDP growth rate of 0.9%. The 2011 deficit reduction outlined in the March 2010 update of the stability programme was based on a number of consolidation measures mostly to restrain expenditure in various areas of government action such as social transfers and the wage bill of the government, and, to a lesser extent, to raise additional tax revenue, while spending containment would be partially mitigated by fast-rising interest expenditure. In the Commission services' spring 2010 forecast, the 2011 government deficit was projected at 7.9% of GDP, which was 1¼% of GDP above the stability programme target; the GDP growth rate was set at 0.7%.

On 13 May, the 2011 deficit target was revised to 4.6% of GDP reflecting the consolidation measures announced on that day, i.e., 2.7 pps. below the revised 2010 deficit target. These measures would lead to a largely parallel improvement in the Commission services' deficit forecast of 2011 by 2.2% of GDP, so essentially leaving unchanged the original gap between the two projections. In all, taking into account the concrete measures announced both in the March 2010 stability programme and on 13 May, total consolidation effort for both 2010 and 2011 is equally divided between expenditure and revenue.

The stability programme plans aimed at an improvement of the structural balance of 1½ pp of GDP in 2011, in comparison with 2010. According to the Commission services' spring 2010 forecast, and under a no-policy change assumption, the structural deficit could improve by ¾ pp. of GDP in 2011. In the light of the announcement of the additional measures in mid May, the improvement in the structural balance can now be expected to be close to 1¾ pp. of GDP.

This overall outlook for fiscal consolation in 2010 and 2011 compares with the call in the Council Recommendation under Article 126(7) TFEU for an average annual fiscal effort of 1¼% of GDP over the period 2010-2013. However, given that the 2009 budgetary outcome was worse than the deficit projected in the Commission autumn 2009 forecast, the size of the

[21] Improvement in the nominal fiscal balance between 2009 and 2010 reflects also the expiration of some deficit-increasing one-off measures in 2009 and the implementation of deficit-reducing ones in 2010.

appropriate fiscal adjustment must be seen also against the need of having larger-than-recommended fiscal efforts to meet the objective of bringing the government deficit below 3% of GDP in a credible and sustained manner by 2013. Moreover, in order to reach the revised government deficit target for 2010, a strict implementation of budgetary plans for the rest of 2010 is needed, namely by avoiding any expenditure slippage and saving any better-than-expected tax inflow, which should also benefit from the higher-than-expected GDP outturn in the first quarter of 2010 (on the basis of the quarterly national accounts figures published on 9 June 2010)[22],[23].

As for the revised 2011 government deficit target, a consolidation effort – in addition to all the detailed measures announced up to this date – amounting to 1½ pp. of GDP, reflecting the earlier identified budgetary gap between the March 2010 stability programme and the Commission spring 2010 forecasts outlooks would need to be enshrined in the 2011 Budget Law. While both expenditure and revenue measures may have comparable impact on short-term fiscal consolidation, further measures could be tilted towards spending cuts given the current weights of expenditure and revenue in terms of GDP and the need to implement fiscal policies that contribute to restore competitiveness.

Concerning 2012 and 2013, the March 2010 update of the stability programme targeted government deficits of 4.6% and 2.8% of GDP respectively. The structural balance was projected to improve by an annual average of almost 1¾ pp. of GDP in those two years. Part of deficit reduction was planned to reflect discretionary efforts on basis of the consolidation measures already outlined in the programme, largely to contain spending. In addition, fiscal consolidation would be further helped by a gradually accelerating GDP and by a visibly rising tax burden. Though the deficit targets for 2012 and 2013 have not been changed, one may expect them to be revised in line with the new targets for 2010 and 2011.

Portugal's government debt rose to 76.8% of GDP at the end of 2009. The March 2010 update of the stability programme envisaged the debt-to-GDP ratio to increase further up to 90.7% by 2012 reflecting high deficits and low economic growth before bending slightly down to 89.8% in 2013. As for the stock-flow adjustment (SFA), it was planned to be neutral to the change of debt ratio between end 2009 and end 2013, adding to the ratio in 2010 but subtracting from it thereafter. On the one hand, the SFA will benefit from privatisation proceeds amounting to a cumulative 3% of GDP between 2010 and 2013. On the other hand, that is planned to be offset by debt-increasing financial transactions and a positive difference between the cash- and accrual-based deficits. The Commission services' spring 2010 forecast projects the debt ratio at 85.8% of GDP in 2010 and at 91.1% of GDP in 2011. The more recent consolidation measures should result in lower debt levels.

Plans to reform the budgetary framework were outlined in the March 2010 update of the stability programme, with a major element being a move towards a multi-annual budgetary framework. A working party has been established meanwhile with a view to redesign the

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[22] In addition, the results of the long-planned revision in GDP series published on 9 June 2010 work towards the achievement of lower deficit-to-GDP ratios, to the extent that the level of GDP at current market prices for the period 1995-2009 is now some 3¼% higher than previously estimated.

[23] The Council Opinion on the March 2010 update of the stability programme invited Portugal to "achieve the 2010 deficit target of 8.3% of GDP, if necessary by reinforcing the consolidation by adopting additional measures; back-up the strategy to bring the deficit below 3% by 2013 by the timely implementation of concrete measures; stand ready to adopt further consolidation measures in case the macroeconomic scenario proves more favourable than the scenario underpinning the Article 126(7) recommendation and/or any slippages emerge(…)".

framework, with a draft being expected by end June 2010. The working party was mandated to take into account: i) the definition of the set of entities to be affected by the government budgetary process; ii) the proposal of a calendar for the budgetary process; iii) the definition of a multi-year budgetary framework allowing also for performance budgeting; and, iv) the reinforcement of data reporting mechanisms. In addition, some further changes towards a more integrated reporting of budgetary execution on an accrual basis were already envisaged in the stability programme.

10.3. Conclusions

On current information it appears that Portugal has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, the Portuguese authorities have taken measures that represent an annual fiscal effort of significantly more than 1¼% of GDP in both 2010 and 2011.

The Portuguese authorities have announced with detail a number of fiscal consolidation measures to underpin the consolidation path up to 2013, for which implementation has already started in some cases.

However, achieving the plans to correct the excessive deficit by the deadline crucially relies upon a quick and effective implementation of all corrective measures announced in both the March 2010 stability programme and on 13 May. Moreover, further corrective efforts should be included in the 2011 Budget Law in order to attain the annual deficit targets, also so as to take a decisive step to ensure that the debt ratio embarks on a downward path before the end of the correction period. Those efforts will have to be designed taking into account the possibility that fiscal restraint takes a toll on economic growth over the short and medium term before the benefits of a sounder macroeconomic setting allowed by more sustainable public finances materialises. The timing of additional measures can only benefit from bearing in mind the need to bolster confidence and credibility at early stages of the consolidation process. Also steps have been taken to strengthen the budgetary framework, notably to develop its multi-annual elements – pursuing due efforts in this area can be instrumental to facilitate fiscal consolidation over the coming years.

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

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013
Real GDP (% change)	COM	1.9	0.0	-2.7	0.5	0.7	n.a.	n.a.
	SP		0.0	-2.7	0.7	0.9	1.3	1.7
Output gap[1] (% of potential GDP)	COM	0.8	0.2	-2.5	-2.4	-2.2	n.a.	n.a.
	SP		0.5	-2.2	-1.9	-1.6	-1.3	0.8
General government balance (% of GDP)	COM	-2.7	-2.8	-9.4	-8.5	-7.9	n.a.	n.a.
	SP		-2.7	-9.3	-8.3	-6.6	-4.6	-2.8
	New target[3]				-7.3	-4.6	n.a.	n.a.
Primary balance (% of GDP)	COM	0.2	0.1	-6.6	-5.5	-4.4	n.a.	n.a.
	SP		0.2	-6.4	-5.1	-2.8	-0.6	1.3
Cyclically-adjusted balance[1] (% of GDP)	COM	-3.0	-2.9	-8.3	-7.5	-7.0	n.a.	n.a.
	SP		-2.9	-8.3	-7.5	-5.9	-4.0	-2.5
Structural balance[2] (% of GDP)	COM	-3.1	-3.8	-8.1	-7.7	-7.0	n.a.	n.a.
	SP		-2.9	-8.3	-7.5	-5.9	-4.0	-2.5
Government gross debt (% of GDP)	COM	63.6	66.3	76.8	85.8	91.1	n.a.	n.a.
	SP		66.3	77.2	86.0	89.4	90.7	89.8

Note:

[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] Cyclically-adjusted balance excluding one-off and other temporary measures.

[3] New targets for the government balance for 2010 and 2011 as announced by the authorities on 13 May 2010

Source: Commission services' 2010 spring forecast (COM) and March 2010 stability programme update (SP)

11. SLOVENIA

11.1. Excessive deficit procedure and most recent recommendations

On 2 December 2009, the Council decided that an excessive deficit existed in Slovenia in accordance with Article 126(6) of the Treaty on the Functioning of the European Union (TFEU) and addressed recommendations to Slovenia in accordance with Article 126(7) with a view to bringing an end to the situation of an excessive government deficit[24].

The Council recommended Slovenia to put an end to the present excessive deficit situation by 2013. The Slovenian authorities should 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 Slovenian authorities should: (a) implement the fiscal consolidation measures in 2010 as planned; (b) ensure an average annual structural budgetary adjustment of ¾% of GDP over the period 2010-2013; and (c) specify 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.

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

To reduce the risks to the long-term sustainability of public finances, Slovenia should further reform the pension system with a view to curbing age-related expenditures as soon as possible.

The Council established the deadline of 2 June 2010 for the Slovenian government to take effective action to implement the fiscal consolidation measures in 2010 as planned and to outline the measures that would be necessary to progress towards the correction of the excessive deficit. The assessment of effective action takes into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

11.2. Assessment of action taken

Real GDP fell by 7.8% in 2009, more than projected in the Commission services' autumn 2009 forecast (7.4%). The Commission services' spring 2010 forecast revised slightly downwards the outlook for real GDP growth in 2010 and 2011 compared to the Commission services' autumn 2009 forecast, which underpinned the Council recommendation (1.1% vs. 1.3% and 1.8% vs. 2.0%, respectively). This mainly reflects a downward revision in the contribution of net exports to GDP growth for all three years. Inflation and employment projections from the spring 2010 forecast diverge only slightly from the previous projections.

According to the April 2010 EDP notification, the general government deficit in 2009 stood at 5.5% of GDP, slightly lower than in both the Commission services' autumn 2009 forecast and the January 2010 stability programme update. The deficit target for 2010 was set at 5.8% of GDP, slightly higher than 5.7% of GDP set in the stability programme on account of a higher deficit in the Health Insurance Fund. The target incorporates the measures adopted by the government in the context of the budget for 2010 to restrain primary expenditure growth, confirming its intention to pursue an expenditure-based fiscal consolidation. These measures include an agreed postponement of public sector wage increases, less generous indexation of social benefit rates, including pensions, and lower capital transfers due to increased reliance on EU funds. Together, they are expected to generate savings of around 1¼% of GDP compared to a no-policy-change scenario. The Commission services’ spring 2010 forecast projects the 2010 general government deficit at 6.1% of GDP, corresponding to lower nominal GDP, more cautious assumptions regarding indirect tax buoyancy and slightly higher capital expenditure projections.

Given a sharp rise in the interest burden and still strong inherent primary expenditure dynamics in spite of the above-mentioned savings, the structural balance, i.e. the cyclically-adjusted balance net of one-off and other temporary measures, is estimated to worsen by around ¾ pp. of GDP in 2010 according to the spring forecast. This contrasts with the average annual fiscal effort of ¾ pp. of GDP as recommended under Article 126(7), which would require an above-average fiscal effort for the period 2011-2013. Still, as the consolidation measures for 2010 are being implemented as planned, the budgetary strategy in 2010 is broadly consistent with the Council recommendation. Furthermore, on 10 June 2010, in reaction to the worse economic outlook compared to when the budget for 2010 was presented and lower-than-budgeted revenues over the first five months in cash terms[25], the government adopted additional consolidation measures in a supplementary budget with a view to bringing

[25] This revenue shortfall may also imply an upward revision of the 2009 general government deficit outturn in ESA95 terms.

the 2010 central government deficit-to-GDP ratio in cash terms back in line with the target in the 2010 budget.

The main aim of the Slovenian medium-term budgetary strategy, laid down in the stability programme, is to reduce the deficit below the 3% of GDP deficit reference value by 2013, the correction deadline set by the Council. This strategy relies on a broad-based containment of primary expenditure involving enhanced public sector efficiency and the rationalisation of the provision of public services and social protection and the broad measures underpinning it from 2011 onwards are indicated in the stability programme. The budgetary projections in the programme also incorporate the expiry of all remaining temporary stimulus measures. In its opinion of 27 April 2010 on the stability programme, the Council highlighted risks to the budgetary targets in the programme related to (i) possible expenditure overruns in view of the scale of the envisaged retrenchment coupled with the strong observed dynamics in recent years of especially the wage bill and social transfers; (ii) the fact that the expenditure-containment measures have not yet been fully specified and adopted; and (iii) lower-than-foreseen revenues after 2011 in view of the favourable macroeconomic scenario.

Concerning the Council recommendation on long-term sustainability, the government's "Exit Strategy 2010-2013" adopted in February 2010 sets out plans for a comprehensive two-step pension reform, which is currently being negotiated with social partners. Also, the recently established fiscal council presented its first assessment of Slovenia's fiscal policy in April, following which there may be further developments in the fiscal framework.

11.3. Conclusions

On current information it appears that Slovenia has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, the consolidation measures in the budget for 2010, estimated to generate expenditure savings of around 1¼% of GDP in 2010 compared to a no-policy change scenario are being implemented as planned. Furthermore, the government adopted a supplementary budget on 10 June to reconfirm the targeted deficit ratio for central government in cash terms in the light of worse economic and budgetary developments since the adoption of the budget.

For the period 2011-2013, the Slovenian authorities have outlined in some detail a consolidation strategy based on a broad-based containment of primary expenditure to gradually bring the deficit below 3% of GDP by 2013, the deadline recommended by the Council. In order to achieve the targets it will be important to fully spell out and adopt the underlying measures and to address possible expenditure slippages or revenue shortfalls. Regarding the recommendation to reduce the risks to the long-term sustainability of public finances, a comprehensive two-step pension reform is currently being negotiated with social partners.

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

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013
Real GDP (% change)	COM	6.8	3.5	-7.8	1.1	1.8	n.a.	n.a.
	SP	n.a.	3.5	-7.3	0.9	2.5	3.7	3.5
Output gap[1] (% of potential GDP)	COM	6.3	6.6	-3.7	-3.7	-3.2	n.a.	n.a.
	SP	n.a.	5.7	-3.4	-3.9	-3.2	-1.5	0.1
General government balance (% of GDP)	COM	0.0	-1.7	-5.5	-6.1	-5.2	n.a.	n.a.
	SP	n.a.	-1.8	-5.7	-5.7	-4.2	-3.1	-1.6
Primary balance (% of GDP)	COM	1.3	-0.6	-4.1	-4.3	-3.3	n.a.	n.a.
	SP	n.a.	-0.7	-4.6	-3.9	-2.3	-1.1	0.4
Cyclically-adjusted balance[1] (% of GDP)	COM	-2.9	-4.8	-3.8	-4.4	-3.8	n.a.	n.a.
	SP	n.a.	-4.3	-4.2	-4.0	-2.8	-2.4	-1.6
Structural balance[2] (% of GDP)	COM	-2.9	-4.8	-3.7	-4.4	-3.8	n.a.	n.a.
	SP	n.a.	-4.3	-4.2	-4.0	-2.8	-2.4	-1.6
Government gross debt (% of GDP)	COM	23.4	22.6	35.9	41.6	45.4	n.a.	n.a.
	SP	n.a.	22.8	34.4	39.6	42.0	42.7	42.1

Note:

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

[2] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Commission services' 2010 spring forecast (COM) and January 2010 stability programme update (SP)

12. SLOVAKIA

12.1. Excessive deficit procedure and most recent recommendations

On 2 December 2009, the Council decided that an excessive deficit existed in Slovakia in accordance with Article 126(6) of the Treaty on the Functioning of the European Union (TFEU) and addressed recommendations to Slovakia in accordance with Article 126(7) with a view to bringing an end to the situation of an excessive government deficit[26].

The Council recommended Slovakia to put an end to the present excessive deficit situation by 2013. The Slovak authorities should 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 Slovak authorities should: (a) implement the deficit reducing measures in 2010 as planned in the draft budget for 2010-2012; (b) ensure an average annual fiscal effort of 1 % of GDP over the period 2010-2013; (c) specify 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.

To limit risks to the adjustment, Slovakia should strengthen the enforceability of its medium-term budgetary framework as well as improve the monitoring of the budget execution throughout the year, in particular to avoid expenditure overruns compared to budget plans.

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

The Council established the deadline of 2 June 2010 for the Slovak government to take effective action to implement the deficit reducing measures in 2010 as planned in the draft budget for 2010-2012 and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

12.2. Assessment of action taken

According to the Commission services' 2010 spring forecast, real GDP in 2010 is expected to increase by 2.7%, compared to 1.9% projected in the autumn forecast which was the basis for the Council Recommendation. The upward revision is to be attributed to stronger economic performance from the end of 2009 reflecting dynamic foreign demand. For 2011, real GDP is foreseen to grow by 3.6% as compared to 2.6% in the autumn forecast, reflecting a faster pick up in demand from households and foreign trading partners. Nevertheless, the output gap is projected to remain negative in 2010 and 2011.

In its tri-annual draft budget published in September 2009, the Slovak government presented a consolidation strategy for public finances starting in 2010. The general government deficit would be reduced to 5.5% of GDP in 2010 (from an estimated 6.3% of GDP in 2009). Continued consolidation efforts in subsequent years would bring the nominal deficit to 3% of GDP already in 2012, one year before the deadline recommended by the Council.

The January 2010 update of the stability programme confirmed the target of a general government deficit of 5.5% of GDP in 2010, assuming real GDP growth of 1.9%. The improvement of the deficit in 2010 would primarily reflect expenditure-reducing measures. Savings in goods and services together with cuts in public investment amount to 1.2% of GDP in 2010. The 2010 budget foresees a moderate increase in public wages by 1% (except for employees of the regional school system), and a nominal freeze in salaries of ministers, members of parliament and other political office holders. Moreover, the programme foresaw a reduction of central government employees by some 2% in connection with reorganization of armed forces and a decrease of regional schools' employees. The revenue to GDP ratio was projected to decline by 0.3 percentage point of GDP in 2010 in view of a temporary increase of tax allowances and in-work benefits, and a decline in dividends from public companies.

The Commission services' 2010 spring forecast projects the deficit at 6.0% of GDP (0.5 percentage points of GDP higher than in the stability programme), based on real GDP growth of 2.7%. The difference from the deficit forecast in the stability programme reflects primarily a base effect given the upward revision of the deficit estimate for 2009 in the April 2010 notification (from 6.3% to 6.8% of GDP). The higher growth in the Commission forecast is not expected to translate into higher revenues, reflecting unfavourable growth composition effects. The implied fiscal effort in 2010, as measured by the change in the structural balance, amounts to 1.2 percentage point of GDP, which is slightly above the average annual fiscal effort of 1% of GDP recommended by the Council. The expected improvement in the structural balance reflects broadly the envisaged expenditure-cutting measures.

Currently available central government cash-based figures suggest that expenditures have not deviated substantially from the budget plan. Nevertheless, these data do not include spending of social security funds, public health care insurances and local governments. However, developments on the revenue side point to downside risks in 2010. Firstly, the government reduced the excise duty on diesel fuels in January 2010, leading to an expected loss of revenues of 0.1-0.2 percent of GDP. Secondly, figures on tax collections for the first four months of 2010 point to a significant underperformance of personal income and corporate taxes (even compared to the Commission spring forecast). Although no detailed information is available, revenue from social contributions may underperform too given the worse-than-expected labour market developments.

After 2010, the consolidation strategy assumes the withdrawal of anti-crisis measures (i.e. increase in tax allowance and in-work benefits) and further reduction of expenditure on goods and services. The supporting measures have however not yet been fully specified. The authorities also plan a reduction in capital expenditure from 1.6% of GDP in 2010 to 1.2% of GDP in 2012. According to the authorities, these measures will be sufficient to bring the deficit down to 3% of GDP in 2012, one year earlier than recommended by the Council. However, in view of favourable macroeconomic assumptions for these years in the stability programme and corresponding possible negative surprises in tax revenues, achievement of these targets may require additional consolidation measures.

The authorities have announced in the stability programme their intention to strengthen the current three-year fiscal framework. The government contemplates the introduction of more binding expenditures ceilings covering a large share of government expenditure, adoption of a constitutional law setting an upper limit on government debt, and a strengthened monitoring of the budget execution during the year. These measures are welcome, and would result in a more robust institutional set-up for the conduct of fiscal policy. Nevertheless, little concrete progress has been done in this respect until now.

12.3. Conclusions

On current information it appears that Slovakia has taken action representing adequate progress towards the correction of the excessive deficit within the time limits set by the Council. In particular, the Slovak authorities have implemented several deficit reducing measures in 2010, which are expected to result in a sizeable improvement of the structural balance amounting to 1.2 percentage point of GDP.

The Slovak authorities have outlined in some detail a medium-term consolidation strategy envisaging correction of the excessive deficit by 2012, a year ahead of the deadline recommended by the Council. In order to achieve this target, it will be important to rigorously implement the 2010 budget and stand ready to adopt additional measures if necessary to reach the deficit target of 5.5% of GDP. The 2011 budget should include measures necessary to reach the fiscal targets presented in the stability programme and, to the extent possible, avoid cuts in public investment. Furthermore, the Slovak authorities have initiated work to strengthen the enforceability of the medium-term fiscal framework through the introduction of expenditure ceilings, a limit on general government debt, and stronger budget execution monitoring. These measures are welcome and the authorities are invited to continue their efforts in this area.

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

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011	2012	2013
Real GDP (% change)	COM	10.6	6.2	-4.7	2.7	3.6	n.a.	n.a.
	SP	n.a.	6.4	-5.7	1.9	4.1	5.4	n.a.
Output gap[1] (% of potential GDP)	COM	6.3	7.6	-1.2	-2.3	-2.3	n.a.	n.a.
	SP	n.a.	8.9	-1.1	-2.9	-3.0	-1.0	n.a.
General government balance (% of GDP)	COM	-1.9	-2.3	-6.8	-6.0	-5.4	n.a.	n.a.
	SP	n.a.	-2.3	-6.3	-5.5	-4.2	-3.0	n.a.
Primary balance (% of GDP)	COM	-0.5	-1.1	-5.3	-4.5	-3.9	n.a.	n.a.
	SP	n.a.	-1.1	-4.5	-3.6	-2.3	-1.1	n.a.
Cyclically-adjusted balance[1] (% of GDP)	COM	-3.7	-4.5	-6.4	-5.4	-4.7	n.a.	n.a.
	SP	n.a.	-4.9	-6.0	-4.7	-3.3	-2.7	n.a.
Structural balance[2] (% of GDP)	COM	-3.7	-4.7	-6.6	-5.4	-4.7	n.a.	n.a.
	SP	n.a.	-4.2	-6.0	-4.7	-3.3	-2.7	n.a.
Government gross debt (% of GDP)	COM	29.3	27.7	35.7	40.8	44.0	n.a.	n.a.
	SP	n.a.	27.7	37.1	40.8	42.5	42.2	n.a.

Note:

[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] Cyclically-adjusted balance excluding one-off and other temporary measures.

Source: Commission services' 2010 spring forecast (COM) and January 2010 stability programme update (SP)

ANNEX 2: ASSESSMENT OF NEW TARGETS AND ADDITIONAL MEASURES BY SPAIN AND PORTUGAL

1. SPAIN

On 9 May, the ECOFIN Council agreed that plans for fiscal consolidation and structural reforms would have to be accelerated and strongly supported the commitment of Spain to take significant additional consolidation measures in 2010 and 2011. In addition, it was agreed that the adequacy of such measures would be assessed by the Commission in June in the context of the excessive deficit framework.

As a reaction to the agreement at the ECOFIN Council, Spain announced on 12 May a number of additional consolidation measures, which underpinned a downward revision of government deficit targets by 0.5% of GDP in 2010 and of 1.5% of GDP in 2011 (in cumulative terms), in comparison with the plans outlined in the February 2010 stability programme. The fiscal targets are now a deficit of 9.3% of GDP for 2010 and one of 6% of GDP for 2011 (revised from previous deficit targets of 9.8% and 7.5% of GDP for 2010 and 2011 respectively in the February 2010 stability programme). The measures are all made up of expenditure cuts and the most sizeable ones concern: government wages, with a cut by 5% in nominal wages on average as of mid 2010, and their freeze in 2011; a reduction of public investment; a freeze on pensions (except for the lowest pension outlays); phasing out of the tax allowance in the personal income tax for birth or adoption of a child; and, cuts in transfers to regional and local governments. (See Table 1 for more details on the measures outlined by Spain and their budgetary impact as announced by the authorities).

Table 1: Spain: Consolidation measures announced on 12 May

	Impact (% of GDP) (compared with plans of SP of February 2010)	
	2010	**2011**
Revenue-increasing measures (a)	–	–
Expenditure-decreasing measures (b)	**0.5**	**1.5**
- Cut in public wages (5% on average, up to 15% to higher wages)	0.2	0.4
- Non indexation of pensions (excluding minimum pensions) from January 2011	–	0.1
- Abrogation of temporary rules for partial retirement (law 40/2007)	...	...
- Elimination of birth allowance (EUR 2500 per birth)	–	0.1
- Reduction in medical expenditure	...	0.1
- Reduction in other social benefits (dependency law)	...	...
- Reduction in investment	0.2	0.4
- Reduction in transfers to regional and local governments	...	0.1
- Reduction in official development aid	...	0.1
Grand total (a+b)	**0.5**	**1.5**

Notes:
–: nil
…: negligible

The assessment of the new budget deficit targets and of the adequacy of the underlying consolidation measures should take into account several criteria: not only the adequacy of the announced measures to meet the new fiscal targets for both 2010 and 2011, but also the quality and composition of the measures, and accompanying structural reforms. In addition, it is also assessed whether the new targets are suffice to stabilise, and reverse, the debt ratio by 2013.

The measures announced by Spain on 12 May correspond to the revisions in the government targets, when one takes the quantification of the measures announced by Spain[27] (See Table 1 for details on the announced measures and their quantification.), taking into account the deviations between projections and targets identified in the Commission services' spring 2010 forecasts, as well as the fact that the acceleration in fiscal consolidation will weigh on economic activity, the conclusion is that the recently announced measures might not suffice to reach the revised targets for 2011.

Table 2 below presents the order of magnitude of the fiscal consolidation measures that Spain will have to specify in the 2011 budget in order to reach its new government deficit targets. The tables takes into account the announcements made by the Spanish authorities concerning their revised targets, as well as the new consolidation measures. The tables should be read as follows: Line (1) shows the target fiscal deficit for 2010 and 2011 in the latest update of the stability programme (March 2010). Line (2) shows the Commission services' projection for the same variable (spring 2010 forecasts). Line (3) shows the new fiscal targets. The revision in targets is in line (4), while the difference between the Commission forecasts and the new target features in line (5). The measures that are necessary to reach the new targets are in line (6); this variable takes into account not only line (5), but also second-round effects: the fact that the acceleration in consolidation will weigh on economic activity, which will then partially offset of the deficit-decreasing impact on the consolidation measures[28]. The recently announced measures are in line (7), while line (8) indicates the measures in addition of those announced on 13 May that would be necessary to reach the new targets.

The tables also contain information on government debt developments in the stability programme (line 9), in the spring forecasts (10) and assuming that the new deficit targets are fully achieved (11). Lines (12) and (13) show the real GDP growth rates in the stability programme and in the spring forecast.

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27 The risks on the implementation and quantification of the announced measures are relatively small but cannot simply be discarded. For example, the cut in transfers to regional and local governments may not imply a similar reduction in regional and local expenditure.

28 Total government revenues can be expected to fall short of expectations as the effects on output of consolidation may be sizeable owing to persistent credit and liquidity constraints, while some expenditure components may be higher than assumed so far.

Table 2: Spain: measures required to meet the 2010 and 2011 targets

SPAIN		% of GDP (u.o.i)	
		2010	2011
1	Government balance (target in the Stability programme)	-9.8	-7.5
2	Government balance (COM spring forecast)	-9.8	-8.8
3	Government balance (New target)	-9.3	-6.0
4 = 3 – 1	Revision in targets	0.5	1.5
5 = 3 – 2	Difference between COM forecasts and new target	0.5	2.8
6	Measures to reach new target taking into account second round effects on economic activity (*)	0.6	3¼
7	Measures announced on 13 May	0.5	1.5
8 = 6 – 7	Additional measures needed on top of those announced on 13 May	marginal	1¾
8a	o/w: Measures to be taken in 2010 (on top of those already announced on 13 May)	marginal	–
8b	o/w: measures to be taken in 2011 (on top of those already announced on 13 May)	–	1¾
	measures to be spelled out to achieve the new expenditure ceilings announced on 28 May		1
	new measures		¾
9	Government debt (target in the stability programme)	65.9	71.9
10	Government debt (COM spring forecasts)	64.9	72.5
11	Government debt (assuming achievement of revised targets)	64.3	70.6
12	Real GDP (growth % change) (Stability programme)	-0.3	1.8
13	Real GDP (growth % change) (COM spring forecasts)	-0.4	0.8

Note:
(*) Figures in line (6) take into account the impact of consolidation measures on short-term GDP growth prospects as compared with the 2010 spring forecast. These effects are based on Commission estimates of economic multipliers, although they ignore possible positive confidence effects of fiscal consolidation on GDP growth

For 2010, no additional measures would be necessary. Table 2 shows that, to reach the revised deficit targets for 2011, measures amounting to some 1¾% of GDP in 2011 should be presented in the 2011 budget. Part of this consolidation would be achieved by respecting the expenditure ceilings announced on 28 May 2010, which would imply a deficit reduction of 1% of GDP. However, the individual measures for achieving this target still need to be specified. For 2011, the measures reflect both the gap identified in the spring forecasts[29], as well as their impact on economic activity.

An assessment of the measures announced by Spain should also consider the composition of those measures, their durability and whether they are accompanied by appropriate structural measures. The new measures announced by Spain are all on the expenditure side; they add to measures in the 2010 budget (and in the February stability programme) that were in equal

29 Furthermore, the latest revenue developments appear stronger than projected in the Commission services' 2010 spring forecast.

shares on the expenditure and revenue sides. Therefore, for 2010, total measures are ca. four-tenths revenue increasing and six-tenths expenditure cuts. For 2011, concrete consolidation measures announced so far are expenditure cuts.

While both expenditure and revenue measures have the same impact on short-term fiscal consolidation, experience shows that expenditure cuts are more effective in a medium-term perspective than revenue increases. This is all the more true for countries that need to recover competitiveness, as revenue increases will directly or indirectly add to production costs. Although the consolidation needs of Spain are such that they need to contain both revenue and expenditure measures, it would be advisable further consolidation measures to be focused on expenditure cuts.

The implementation of structural measures is key to increase GDP growth potential. Structural measures should help counter some of the drag in economic activity resulting from sizeable fiscal consolidation. Although such measures will produce full results in a medium- to long-term horizon, some positive short-term impact can be expected on confidence, so they should be enacted without delay. Particularly important for Spain are reforms aimed at addressing labour market segmentation and improving flexibility through reforms of employment protection legislation and wage formation. The rapid implementation of such a reform may lead to higher employment growths, which can lower the current high level of precautionary savings and accelerate private consumption. Product market reforms to improve business conditions and spur competition in key sectors of the economy are also important, particularly in the case of services and network industries. Last but not least, improving the skills basis is also essential. Spain is expected to announce labour-market measures shortly. An ambitious pension reform has been under discussion for some time; it would be advisable to announce details without further delay; a pension reforms may decisively contribute to fiscal sustainability without short-term costs for growth or the fiscal accounts.

Consolidation efforts should consider the need to stabilise the government debt ratio by 2013. At the end of 2009, the government debt ratio in Spain was 17 percentage points higher than two years earlier. Table 2 shows that the new targets will not be enough to reverse the increasing trend in the debt ratio by next year. In 2011, the debt ratio may increase by more than 6 percentage points to above 70% of GDP, despite a sizable improvement in the fiscal position. These trends illustrate the urgency of reversing debt developments.

2. PORTUGAL

On 9 May, the ECOFIN Council agreed that plans for fiscal consolidation and structural reforms would have to be accelerated and strongly supported the commitment of Portugal to take significant additional consolidation measures in 2010 and 2011. In addition, it was agreed that the adequacy of such measures would be assessed by the Commission in June in the context of the excessive deficit framework.

As a reaction to the agreement at the ECOFIN Council, Portugal revised its government deficit targets for 2010 and 2011 down by 1% and 2% of GDP respectively, in comparison with the March 2010 stability programme plans, and underpinned this revision by a number of additional consolidation measures. Portugal now targets a government deficit of 7.3% of GDP for 2010 and 4.6% of GDP for 2011 (revised from previous deficit targets of 8.3% and 6.6% of GDP for 2010 and 2011 respectively in the stability programme).

On 13 May, the Portuguese authorities presented a number of consolidation measures, which are expected to yield a deficit reduction of 1.2% of GDP in 2010 and of 2.2% of GDP in 2011 (in cumulative terms), in comparison with the plans outlined in the March 2010 stability programme (a small part of those measures is the frontloading into 2010 of initiatives already planned in the programme for 2011). The new measures are mostly on the revenue side as increases in revenue are assumed to yield an improvement in the government balance of 1.4% of GDP by 2011 (cumulative terms) and the expenditure cuts are expected to yield budgetary savings of 0.8% of GDP in cumulative terms by 2011. Major revenue-increasing measures include hikes in all VAT rates and surcharges on personal and on corporate income taxes. The expenditure side includes a wide range of individually small measures, inter alia a quasi freeze in hiring by the central government, lower transfers to public enterprises and cuts in capital spending, reductions in transfers to regional and local governments, tighter rules on social benefits, or introduction of tolls in a number of motorways operating under public-private partnerships. Taking into account the concrete measures announced both in the March 2010 stability programme and on 13 May, total consolidation effort for both 2010 and 2011 is equally divided between the expenditure and revenue sides (see Table 1 for more details on the additional measures outlined by Portugal on 13 May and their budgetary impact as announced by the authorities).

Table 1: Portugal: Consolidation measures announced on 13 May

	Impact (% of GDP) (compared with plans of SP of March 2010)	
	2010	2011
Revenue-increasing measures (a)	**0.6**	**1.4**
- Increase of VAT rates by 1 percentage point (from 5, 12 and 20 to 6, 13 and 21%, respectively)	0.3	0.7
- Additional taxation on personal income (an additional 1 p.p. for up to the third income bracket of personal income tax (PIT) and additional 1.5 p.p. for the other income brackets. Additional 1.5 p.p. in the PIT withholding rates	0.2	0.4
- Additional corporate income tax of 2.5 p.p. to profits over EUR 2 million	0.1	0.2
- Additional taxation on contracts for consumer credit loans	...	…
- Introduction of tolls in a number of motorways	–	0.1
Expenditure-decreasing measures (b)	**0.6 (0.4 **)**	**0.8**
- Introduction of means tests and strengthen mechanisms to allocate and control the eligibility to social benefits	0.1 (*)	–
- Changes in the unemployment benefit scheme		
- Anticipated phasing-out of temporary stimulus measures	0.1 (*)	–
- Reduction in transfers to State-owned enterprises by adopting measures of rationalisation and financial sustainability.	0.2	0.2
- Reduction in the central government expenditure (hiring freezing, work-related allowances, thresholds to the expenditure of autonomous funds and services, blocking of non-compulsory wage supplements; telecommunications)	0.1	0.2
- Reduction by 5% in the wages of holders of political and public management offices	…	…
- Reduction in capital expenditure	0.1	0.2
- Reduction in transfers to regional and local governments	0.1	0.1
Grand total (a+b)	**1.2 (1.0 **)**	**2.2**

Notes:
–: nil
…: negligible
*: Measures already taken into account into the Commission services' spring 2010 forecast.
**: 0.4 expenditure-decreasing measures and 1.0 total measures, if measures already considered in the spring forecasts are excluded

The assessment of the new budget deficit targets and of the adequacy of the underlying consolidation measures should take into account not only the adequacy of the announced measures to meet the new fiscal targets for both 2010 and 2011, but also the quality and composition of the measures, and accompanying structural reforms. In addition, this section also assesses whether the new budget deficit targets represent a substantial and adequate step towards debt stabilisation by 2013.

The direct impact of the measures announced and quantified by Portugal on 13 May is consistent with the revisions in the government targets[30] (see Table 1 for details on the announced measures and their quantification). However, taking into account the deviations between projections and targets identified in the Commission services' spring 2010 forecasts,

[30] The risks on the implementation and quantification of the announced measures are relatively small but cannot simply be discarded. For example, the cut in transfers to regional and local governments may not imply a similar reduction in regional and local expenditure. Likewise, the reduction in transfers to public enterprises will have to be accompanied by measures to improve the financial sustainability of those companies.

as well as the fact that the acceleration in fiscal consolidation will weigh on economic activity, the conclusion is that the recently announced measures might not suffice to reach the revised targets for 2011.

Table 2 below presents the order of magnitude of the fiscal consolidation measures that Portugal will have to specify in the 2011 budget in order to reach its new government deficit targets. The tables takes into account the announcements made by the Portuguese authorities concerning their revised targets, as well as the new consolidation measures. The table should be read as follows: Line (1) shows the target fiscal deficit for 2010 and 2011 in the latest update of the stability programme (March 2010). Line (2) shows the Commission services' projection for the same variable (spring 2010 forecasts). Line (3) shows the new fiscal targets as of 13 May. The revision in targets is in line (4), while the difference between the Commission forecasts and the new target features in line (5). The measures that are necessary to reach the new targets are in line (6); this variable takes into account not only line (5), but also second-round effects: the fact that the acceleration in consolidation will weigh on economic activity, which will then partially offset the deficit-decreasing impact of the consolidation measures[31]. Line (5) takes also into account the long-planned revision in GDP series published on 9 June 2010, which resulted in a level of GDP at current market prices for the period 1995-2009 that is now some 3¼% higher than previously estimated. The recently announced measures are in line (7), while line (8) indicates the measures in addition of those announced on 13 May that would be necessary to reach the new targets. The table also contains information on government debt developments in the stability programme (line 9), in the spring forecasts (10) and assuming that the new deficit targets are fully achieved against the backdrop of the new GDP series figures (11). Lines (12) and (13) show the real GDP growth rates in the stability programme and in the spring forecasts.

[31] Total government revenues can be expected to fall short of expectations as the effects on output of consolidation may be sizeable owing to persistent credit and liquidity constraints, while some expenditure components may be higher than assumed so far.

Table 2: Portugal: measures required to meet the 2010 and 2011 targets

PORTUGAL		% of GDP (u.o.i) 2010	2011
1	Government balance (target in the Stability programme)	-8.3(*)	-6.6(*)
2	Government balance (COM spring forecast)	-8.5(*)	-7.9(*)
3	Government balance (New target)	-7.3	-4.6
4 = 3 – 1	Revision in targets	1.0	2.0
5 = 3 – 2	Difference between COM forecasts and new target	1.2	3.3
6	Measures to reach new target taking into account second round effects on economic activity and taking into account the upward revision in the GDP series (***)	1.1(**)	3.6(**)
7	Measures announced on 13 May	1.0	2.2
8 = 6 – 7	Additional measures needed on top of those announced on 13 May	marginal	1½
8a	o/w: Measures to be taken in 2010 (on top of those already announced on 13 May)	marginal	–
8b	o/w: Additional measures to be taken in 2011 (on top of those already announced on 13 May)	–	1½
9	Government debt (target in the stability programme)	86.0(*)	89.4(*)
10	Government debt (COM spring forecasts)	85.8(*)	91.1(*)
11	Government debt (assuming achievement of revised targets and taking into account the upward revision in the GDP series)	82.0(**)	85.6(**)
12	Real GDP (growth % change) (Stability programme)	0.7	0.9
13	Real GDP (growth % change) (COM spring forecasts)	0.5	0.7

Notes:

(*) On the basis of the old GDP series.

(**) The long-planned revision in GDP series published on 9 June 2010 resulted in a level of GDP at current market prices for the period 1995-2009 that is some 3¼% higher than previously estimated.

(***) Figures in line (6) take into account the impact of consolidation measures on short-term GDP growth prospects as compared with the 2010 spring forecast. These effects are based on Commission estimates of economic multipliers, although they ignore possible positive confidence effects of fiscal consolidation on GDP growth.

For 2010, no additional measures would be necessary. To reach the revised deficit target for 2010, a strict implementation of budgetary plans for the rest of 2010 is needed, namely by avoiding any expenditure slippage and saving any better-than-expected tax inflow, which should also benefit from the higher-than-expected GDP outturn in the first quarter of 2010 (on the basis of the quarterly national accounts figures published on 9 June 2010)[32].

Table 2 shows that, to reach the revised deficit targets for 2011, measures amounting to some 1½% of GDP in 2011 should be presented in the 2011 budget. For 2011, the measures reflect both the gap identified in the spring forecasts, as well as their impact on the economy.

[32] In addition, the long-planned revision in GDP series published on 9 June 2010 work towards the achievement of lower deficit-to-GDP ratios, to the extent that the level of GDP at current market prices for the period 1995-2009 is now some 3¼% higher than previously estimated.

An assessment of the measures should also consider their composition, their durability and whether they are accompanied by appropriate structural reforms. Taking into account the concrete measures in the stability programme, total consolidation effort for both 2010 and 2011 is half on expenditure, half on the revenue side.

While both expenditure and revenue measures have the same impact on short-term fiscal consolidation, experience shows that expenditure cuts are more effective in a medium-term perspective than revenue increases. This is all the more true for countries that need to recover competitiveness, as revenue increases will directly or indirectly add to production costs. Although the consolidation needs of Portugal are such that they need to contain both revenue and expenditure measures, it would be advisable that further consolidation is focused on expenditure cuts.

The implementation of structural measures is key to increase GDP growth potential. Further structural measures should help counter some of the drag in economic activity resulting from sizeable fiscal consolidation. Although such measures will produce full results in a medium- to long-term horizon, some positive short-term impact can be expected on confidence, so they should be enacted without delay. Particularly important for Portugal are reforms aimed at addressing labour market segmentation and further improving flexibility through reforms of employment protection legislation, wage formation and unemployment insurance mechanisms. In parallel, product market reforms to improve business conditions and spur competition in key sectors of the economy are equally important, particularly in the case of services and network industries. Last but not least, improving further the skills basis and the levels of formal education is also essential.

In parallel to the announcement of fiscal measures on 13 May 2010, the Portuguese government stated its intention to accelerate structural reforms in the areas of healthcare, education, energy, reducing red tape and e-government, with the aim of accelerating economic activity, increasing employment and restoring competitiveness. However, no specific steps have yet been announced.

Consolidation efforts should consider the need to stabilise the government debt ratio before 2013. At the end of 2009, the government debt ratio in Portugal was 14¼ percentage points higher than two years earlier. Table 2 shows that the new targets will not be enough to reverse the increasing trend in the debt ratio by next year. In 2011, the debt ratio may increase by almost 4 points to above 88½% of GDP in Portugal. These trends illustrate the urgency of reversing debt developments.