Ten facts about the Excessive Deficit Procedure

Bajo, Anto; Galinec, Davor

Source / Izvornik: **Newsletter : an occasional publication of the Institute of Public Finance, 2013, 15, 1 - 7**

Journal article, Published version
Rad u časopisu, Objavljena verzija rada (izdavačev PDF)

https://doi.org/10.3326/nle.2013.80

Permanent link / Trajna poveznica: https://urn.nsk.hr/urn:nbn:hr:242:054262

Rights / Prava: Attribution-NonCommercial-NoDerivatives 4.0 International/Imenovanje-Nekomercijalno-Bez prerada 4.0 međunarodna

Download date / Datum preuzimanja: **2024-09-02**

Repository / Repozitorij:

Institute of Public Finance Repository

dabar
DIGITALNI AKADEMSKI ARHIVI I REPOZITORIJI

Institute of Public Finance

NEWSLETTER

AN OCCASIONAL PUBLICATION OF THE INSTITUTE OF PUBLIC FINANCE

Zagreb | Smičiklasova 21
office@ijf.hr | www.ijf.hr | tel: +385(0)1 4886 444

doi: 10.3326/nle.2013.80
No. 80 | September 2013 | ISSN 1333-4417

Ten facts about the Excessive Deficit Procedure

ANTO BAJO Institute of Public Finance
DAVOR GALINEC Croatian National Bank[1]

The Stability and Growth Pact (SGP) and the Maastricht criteria lay down the limits on the growth of public debt and budget deficit, as well as the Excessive Deficit Procedure (EDP) for countries which do not comply with the Maastricht's fiscal rules[2]. The European Commission will probably launch an EDP against Croatia as well, given that its budget deficit exceeds the reference value and that its public debt is growing. In such cases the European Commission does not assume control over a Member State's budget execution in the way that it directly proposes measures on either the revenue or expenditure side of the budget. It rather monitors the realisation of the goals set in the Recommendation, with a view to bringing the situation of an excessive government deficit to an end, while the Member State concerned decides on the set of measures to achieve the goals defined in the Recommendation.

1. The Excessive Deficit Procedure is implemented with a view to stabilising the government finance of the EU and of its Member States. According to the Maastricht criteria, the consolidated general government deficit of a Member State must not exceed 3% of its GDP, and the general government debt must not exceed 60% of GDP (according to ESA 95 definitions). Should these thresholds be exceeded, an EDP will be launched, with the main goal to ensure that the Member States comply with the Maastricht criteria. The average government deficit in EU 27 was below 3% of GDP from 1997 to 2008, but rose to over 6% during the next two crisis years. In 2011 and 2012, however, it dropped again to 4%. The European Commission expects a further decline in government deficit to about 3.2% of GDP in 2014 (Chart 1). From 2000 to 2008, the average general government debt in the EU stood at about 60% of GDP, but went up in the following years, reaching 87% of GDP in 2012. As the Member States continue to borrow, the average EU debt is expected to climb to 91% of GDP in 2014 (Chart 2).

2. EDP is applied for three years and, according to the European Commission's recommendations, the deadline for effective actions to correct the excessive deficit is six months. For countries subject to EDP, the adjustment of deficit and public debt takes a minimum of three years. However, there are some exemptions, e. g. Bulgaria, which was under an EDP for two years, its primary goal being to cut

[1] The views and opinions of Davor Galinec expressed in this article are solely his personal and professional attitudes and not necessarily those of the institution with which he is employed, neither are they in any way binding upon it.

[2] The Excessive Deficit Procedure is based on the provisions of the Stability and Growth Pact, criteria set out in the Maastricht Treaty, Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the Excessive Deficit Procedure, and Council Regulation (EC) No 479/2009 on the application of the Protocol on the Excessive Deficit Procedure.

the budget deficit, as its public debt was already low (below the threshold value for an EDP). Should the goals not be achieved and the appropriate actions not taken, the application of the EDP may be extended. Thus, for example, it took Hungary nine years (from 2004 to 2013) to exit from EDP. The European Commission formally launches an EDP against a Member State concerned, issues recommendations to it and sets a deadline of no more than six months for taking actions to reduce the deficit and public debt. Should the European Commission establish that the actions have not been taken or that the results of such actions are poor, it can exert pressure upon the Member State by publicly disclosing the recommendations and imposing sanctions (as an ultimate measure).

3. While being primarily focused on government deficit, the EDP is also applied to public debt. A Member State undergoing an EDP must narrow the gap between its current public debt level and the reference level of 60% of GDP by 1/20 on average p.a. during a three-year period. Assuming a public debt of, e.g. 70% of GDP, Croatia would have to reduce the excess amount of this debt (10% of GDP) by 3/20 or 1. 5% of GDP. As a result, after three years, the total public debt should be reduced from 70% to an "acceptable" level of 68.5% of GDP. After twenty years of implementation of consistent fiscal adjustment measures, the reference share of public debt in GDP of 60% could be achieved (assuming that the growth rate of new borrowing does not exceed that of GDP, minus 1/20 of the excess amount of public debt).

4. The envisaged sanctions for non-compliance with the EDP include fines as a percentage of GDP or the limitation of access to EU funding. The fines for Eurozone member countries are in the form of deposits and are determined at a rate between 0.2% and 0.5% of GDP of the relevant country (pursuant to the so-called "six-pack" set of EU legislation). Other EU Member States may face a temporary suspension of financing from EU funds. Once they meet the EDP criteria, the deposits paid in as fines are returned to the Member States and the access to funding is regained.

5. The importance of fiscal transparency. Where a Member State does not comply with the recommendations within the EDP and fails to submit credible statistics on government deficit and public debt presented in accordance with the ESA 95 principles (twice a year, at end-March and end-July) Eurostat (the statistical office of the European Union) may publicly express its "reservations on the quality of data" and correct the deficit and debt indicators reported by a Member State in its EDP report. The Eurostat notifies the Member State and the President of the Economic and Financial Committee (EFC) of the corrections within a maximum of three days before the corrected indicators are published on the Eurostat's website. Where the Eurostat publicly expresses its "reservations on the quality of data[3]", the next step is to develop an action plan for improvement of EDP statistics of the Member State concerned (which also includes measures to strengthen the human resources preparing EDP reports in national statistical offices) and to conduct a methodological visit to the Member State with a view to addressing the problem and removing the expressed reservations. Through its Report on the Quality of Fiscal Data, Eurostat regularly informs the EFC and European Parliament on the quality of EDP statistics submitted by Member States[4].

6. EDP is based on the ESA 95 methodology which differs from the International Monetary Fund's GFS methodology previously used in Croatia for public finance management. According to ESA 95, government deficit and debt are larger due to a wider coverage of units of the general government sector and types of financial transactions/instruments included in the calculation. The IMF's Government Finance Statistics (GFS 2001) is based on government finance indicators calculated on the basis of data from the national finance ministries (financial reports by budget users and the State

[3] Greece is a very good example of Eurostat's publicly expressed reservations on the quality of EDP data between 2005 and 2009. Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SPLIT_COM:2010:0001(04):FIN:EN:PDF).

[4] The Reports on the quality of government finance are available at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/publications/quality_reports .

Treasury transactions). The ESA 95 concept of government deficit and public debt calculation involves the use of the financial reports of all units statistically classified in the government sector.

On recommendation of the European Commission, loss-making and indebted enterprises owned by the central government or units of local self-government are also classified under the general government sector. The losses and liabilities of certain state-owned firms are thus included in the scope of government deficit and general government debt. Also included are non-financial transactions which affect the deficit and/or debt (such as unilateral write-offs of debt by government as the creditor on behalf of certain categories of debtors, the conversion of government claims into equity, etc.).

In the calculation of general government deficit and debt according to GFS, carried out in Croatia so far, the scope of the local government included only 53 "fiscally most significant" local units. According to ESA 95, however, the local government includes all the units of local self-government (576 of them). Moreover, according to the previous, GFS-based calculations, the operations of the Croatian Health Insurance Fund (CHIF) and the Croatian Pension Insurance Agency (CPIA) were carried out within the government budget. According to ESA 95, however, both the CHIF and CPIA have been reclassified under a sub-sector "social security funds", in order to ensure more transparent monitoring of financial flows between these institutions and the central government.

7. Most of the EU Member States do not meet the Maastricht criteria. In 2012, 16 Member States had higher-than-permitted levels of deficit and 14 countries exceeded the public debt ceiling. In 2012, the largest government deficits (Table 1) were recorded in Spain (10.6% of GDP), Greece (10% of GDP), Ireland (7.6% of GDP), Portugal (6.4% of GDP) and Cyprus and Great Britain (6.3% of GDP each). Only 11 Members States reported deficits below 3% of GDP. From 2009 to 2012, EU-27 Member States reduced their government deficits, but their public debts rose from 74.6% of GDP in 2009 to 85.3% in 2012.

In addition to Greece, the hugest public debts in 2012 were reported by Italy (127% of GDP), Portugal (123.6% of GDP) and Ireland (117.6% of GDP). Only 13 countries had public debts below the 60% ceiling in 2012. These were all new EU Member States (Central and East European countries) and Sweden (Table 2).

8. Twenty-five out of 27 Member States underwent EDP so far. The only countries that have not been subject to an EDP[5] were Estonia and Sweden. Pursuant to a Council decision, EDP was abrogated for Bulgaria and Germany in mid-2012. Luxemburg and Finland were taken out of the procedure in 2010 and 2011 respectively. At the end of the European Semester 2013, Italy, Hungary, Lithuania, Latvia and Romania exited from the procedure, while Malta fell back into EDP.

Sixteen Member States are currently undergoing EDP. Most of them were placed in the procedure in 2009, with the exception of Cyprus and Denmark (in 2010) and Great Britain (in 2008). Among the countries placed in EDP in 2009, Italy, Romania, Latvia and Lithuania were taken out after three years (in 2012). EDP for Belgium was extended until 2013, and probably beyond that year, because the measures taken so far were not effective. Similarly, even after the expiry of three years (i.e. in 2012), six Member States (the Netherlands, Portugal, Slovenia, Poland, France and Spain) did not manage to fully comply with the set targets and recommendations, so that the deadlines for these countries were extended to 2014 or 2015. Hungary is the only Member State that was released from EDP after a full nine years (in 2013).

9. Due to numerous financial risks, Croatia is likely to be placed in an EDP. Croatia has gradually adopted the statistical standards and harmonised its government finance statistics with those of Eurostat. The Croatian Bureau of Statistics (in cooperation with the CNB and the Ministry of Finance) compiles statistics on trends in (excessive) government deficit and public debt. In late September 2013,

[5] As Croatia only recently acquired full membership of the EU, it could not yet be formally placed in an EDP.

Croatia will, as a new Member State, for the first time submit to Eurostat the data on general government deficit and debt within an EDP notification, and in the second half of October, these data will be published (simultaneously) on the websites of Eurostat and the CBS. Currently, the data reported according to the GFS methodology are publicly available in Croatia, i.e. the general government deficit which has exceeded 3% of GDP since 2010 and general government debt which stood at 53.7% of GDP in June 2013. The main reason for launching an EDP against Croatia is its high budget deficit. However, in view of the huge contingent liabilities (called-on government guarantees) and direct liabilities of the CBRD (guaranteed jointly and severally by the government), public debt could also be a cause of launching an EDP, because, due to the wider coverage under ESA 95, it might exceed the reference level of 60% of GDP (Table 3).

There is high likelihood that government guarantees given to Croatian Motorways (HAC) will be called upon, due to unsettled credit liabilities (covered by these guarantees). Should this happen, HAC will be reclassified from the public non-financial corporate sector to the central government sector. As a result, this company's current losses and liabilities will be included in the scope of and increase the general government deficit and debt.

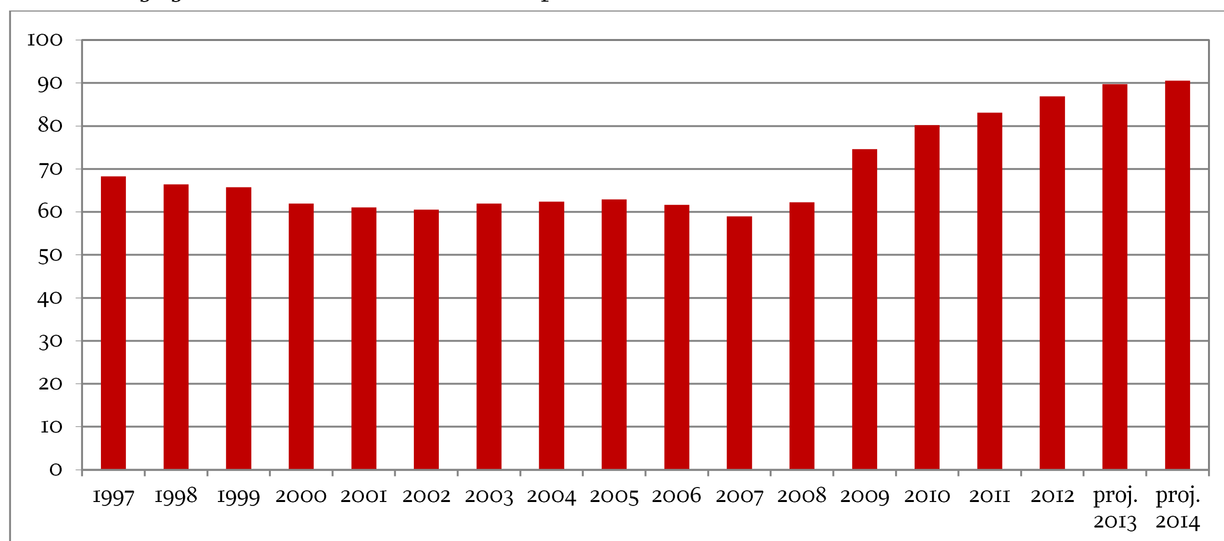
A similar situations is found in Zagrebački holding (a company in the 100%-ownership of the City of Zagreb). Should the company's liabilities be settled by transfers from the budget of the City of Zagreb (including the „sale of real estate and enterprises owned by the Holding to the City of Zagreb") the Holding will be reclassified from the public non-financial corporate sector to the local government sector. Accordingly, by increasing the general government debt, the Holding's liabilities pose a direct threat to public finances.

Changes in Eurostat's scope of debt instruments pose an additional risk of the general government deficit and debt growth. More specifically, pursuant to its Decision of 31 July 2012, Eurostat amended the existing definition of general government debt according to the Maastricht criteria (the debt ceiling of 60% remains the same). The Decision involves the inclusion of trade credits in two cases: the first, when a supplier of goods or services transfers, totally and irrevocably, its claim against a government unit to a financial institution (a factoring company or another financial institution) with the government's consent. The second case relates to the restructuring of trade credits, when there is a bilateral agreement between a supplier and a government unit on additional or new contractual provisions to change the features of an original trade credit (i.e. of the originally agreed timing of repayment), the manner of setting interest rates and/or changing maturity and/or determining the repayment schedule. In both cases, the amounts of the initial trade credit are transferred to the item 'loans', which is included in the scope of EDP general government debt.

The ultimate question is whether an EDP will be launched against Croatia by the end of 2013 (based on the findings of an EDP report to be delivered at end-September 2013) or in mid-2014, i.e. at the end of the European semester.

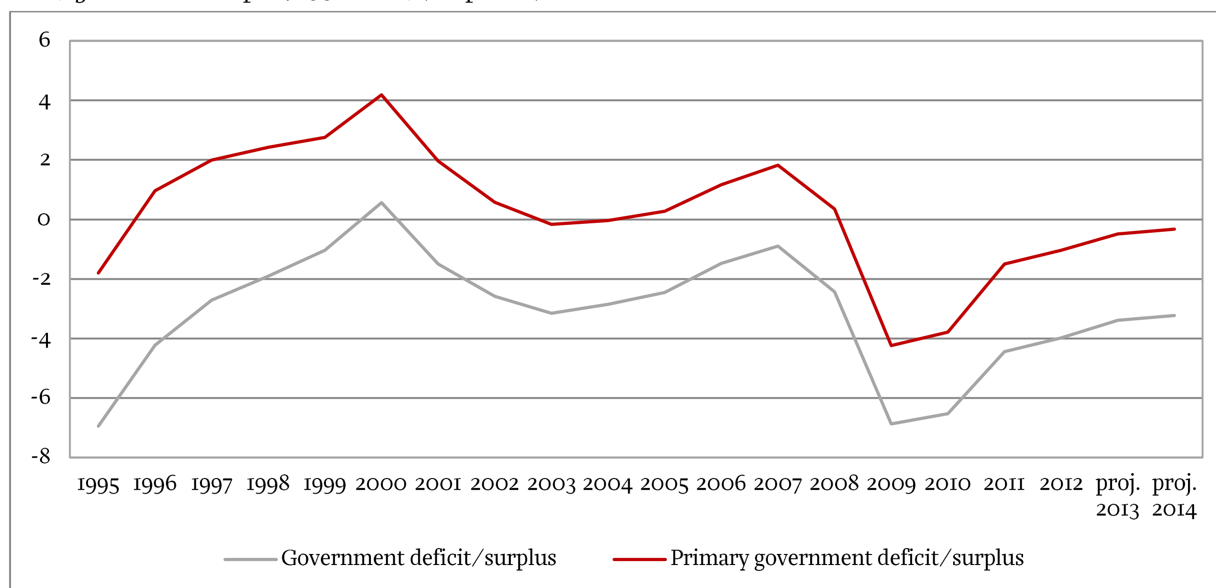
10. The European Commission will not assume control over the Republic of Croatia's budget. When a Member State is placed in an EDP, pursuant to Article 126(7) of the Treaty on the Functioning of the European Union (TFEU), the European Council issues, at the proposal of the European Commission, a recommendation to the Member State to bring the situation of an excessive deficit to an end. The recommendation includes targets which must be met (e.g. if a country runs a deficit of 5% of GDP in 2013, it is expected to reduce the deficit to less than 4% of GDP in 2014 and to less than 3% of GDP in 2015) and a request that the Member State should present and apply the set of measures to be taken with a view to correcting its excessive deficit during the application of the EDP. Hence, the European Commission does not take control over the execution of a Member State's budget in the way that it directly proposes measures on either the revenue or expenditure side of the budget. The European Commission rather monitors the accomplishment of the goals set in the Recommendation, and the Member State determines a mix of measures to achieve the recommended targets.

Chart 1
EU27 average government debt, 1996-2014 (% of GDP)



Note: Projections for 2013 and 2014.
Source: Eurostat, 2013.

Chart 2
EU27 government deficit, 1996-2014 (% of GDP)



Note: Projections for 2013 and 2014.
Source: Eurostat, 2013.

Table 1
General government deficit, 2007-2012 (% of GDP)

	2007	2008	2009	2010	2011	2012
EU27 average	**-0.9**	**-2.4**	**-6.9**	**-6.5**	**-4.4**	**-4.0**
Spain	1.9	-4.5	-11.2	-9.7	-9.4	-10.6
Greece	-6.5	-9.8	-15.6	-10.7	-9.5	-10.0
Ireland	0.1	-7.4	-13.9	-30.8	-13.4	-7.6
Portugal	-3.1	-3.6	-10.2	-9.8	-4.4	-6.4
Cyprus	3.5	0.9	-6.1	-5.3	-6.3	-6.3
Great Britain	-2.8	-5.1	-11.5	-10.2	-7.8	-6.3
France	-2.7	-3.3	-7.5	-7.1	-5.3	-4.8
Czech Republic	-0.7	-2.2	-5.8	-4.8	-3.3	-4.4
Slovakia	-1.8	-2.1	-8.0	-7.7	-5.1	-4.3
the Netherlands	0.2	0.5	-5.6	-5.1	-4.5	-4.1
Denmark	4.8	3.2	-2.7	-2.5	-1.8	-4.0
Slovenia	0.0	-1.9	-6.2	-5.9	-6.4	-4.0
Belgium	-0.1	-1.0	-5.6	-3.8	-3.7	-3.9
Poland	-1.9	-3.7	-7.4	-7.9	-5.0	-3.9
Malta	-2.3	-4,6	-3,7	-3.6	-2,8	3.9
Lithuania	-1.0	-3.3	-9.4	-7.2	-5.5	-3.2
Italy	-1.6	-2.7	-5.5	-4.5	-3.8	-3.0
Romania	-2.9	-5.7	-9.0	-6.8	-5.6	-2.9
Austria	-0.9	-0.9	-4.1	-4.5	-2.5	-2.5
Finland	5.3	4.4	-2.5	-2.5	-0.8	-1.9
Hungary	-5.1	-3.7	-4.6	-4.3	4.3	-1.9
Latvia	-0.4	-4.2	-9.8	-8.1	-3.6	-1.2
Bulgaria	1.2	1.7	-4.3	-3.1	-2.0	-0.8
Luxembourg	3.7	3.2	-0.8	-0.9	-0.2	-0.8
Sweden	3.6	2.2	-0.7	0.3	0.2	-0.5
Estonia	2.4	-2.9	-2.0	0.2	1.2	-0.3
Germany	0.2	-0.1	-3.1	-4.1	-0.8	0.2

Source: Eurostat, 2013.

Table 2
General government debt (consolidated), 2007-2012 (% of GDP)

	2007	2008	2009	2010	2011	2012
EU27 average	**59.0**	**62.3**	**74.6**	**80.0**	**82.5**	**85.3**
Greece	107.4	112.9	129.7	148.3	170.3	156.9
Italy	103.3	106.1	116.4	119.3	120.8	127.0
Portugal	68.4	71.7	83.7	94.0	108.3	123.6
Ireland	25.1	44.5	64.8	92.1	106.4	117.6
Belgium	84.0	89.2	95.7	95.5	97.8	99.6
France	64.2	68.2	79.2	82.4	85.8	90.2
Great Britain	44.2	52.7	67.8	79.4	85.5	90.0
Cyprus	58.8	48.9	58.5	61.3	71.1	85.8
Spain	36.3	40.2	53.9	61.5	69.3	84.2
Germany	65.2	66.8	74.5	82.4	80.4	81.9
Hungary	67.0	73.0	79.8	81.8	81.4	79.2
Austria	60.2	63.8	69.2	72.0	72.5	73.4
Malta	60.7	60.9	66.4	67.4	70.3	72.1
the Netherlands	45.3	58.5	60.8	63.1	65.5	71.2
Poland	45.0	47.1	50.9	54.8	56.2	55.6
Slovenia	23.1	22.0	35.0	38.6	46.9	54.1

Finland	35.2	33.9	43.5	48.6	49.0	53.0
Slovakia	29.6	27.9	35.6	41.0	43.3	52.1
Czech Republic	27.9	28.7	34.2	37.8	40.8	45.8
Denmark	27.1	33.4	40.7	42.7	46.4	45.8
Latvia	9.0	19.8	36.9	44.4	41.9	40.7
Lithuania	16.8	15.5	29.3	37.9	38.5	40.7
Sweden	40.2	38.8	42.6	39.4	38.4	38.2
Romania	12.8	13.4	23.6	30.5	34.7	37.8
Luxembourg	6.7	14.4	15.3	19.2	18.3	20.8
Bulgaria	17.2	13.7	14.6	16.2	16.3	18.5
Estonia	3.7	4.5	7.2	6.7	6.2	10.1

Source: Eurostat, 2013.

Table 3

General government deficit and debt in Croatia, 2005-2013 (% of GDP)

	2005	2006	2007	2008	2009	2010	2011	2012	2013*
General government deficit*	-2.4	-1.5	-1.0	-0.8	-3.3	-4.5	-4.5	-3.8	-3.6
General government debt	38.2	35.4	32.9	29.3	35.8	42.2	47.2	53.7	53.5
Guarantees	4.7	4.9	5.5	9.9	11.7	13.7	14.1	11.7	11.7
CBRD debt	2.7	2.6	3.0	3.1	3.8	4.4	4.0	4.9	4.9
General government debt + guarantees + CBRD debt	45.6	42.9	41.4	42.3	51.3	60.3	65.3	70.3	70.1

**The general government deficit data for 2013 represent planned values, and data on the general government debt, guarantees and CBRD debt are as at 30 June 2013.*

Sources: CNB and Government of the Republic of Croatia (general government deficit data); MoF (data on the general government debt, guarantees and CBRD debt).