EUROPEAN
COMMISSION

Brussels, 2.6.2014
COM(2014) 431 final

COMMUNICATION FROM THE COMMISSION

Assessment of action taken

by POLAND
in response to the Council Recommendation of 10 December 2013 and
by CROATIA
in response to the Council Recommendation of 28 January 2014

with a view to bringing an end to the situation of excessive government deficit

1. INTRODUCTION

On 10 December 2013 and 28 January 2014, respectively, the Council adopted recommendations to Poland and Croatia, with a view to bringing an end to the situation of their excessive government deficit. The Council established deadlines of 15 April 2014 and 30 April, respectively, for these countries to adopt the necessary measures to take effective action to comply with the recommendations and to report in detail on their consolidation strategies that they envisage in order to achieve the targets.

Regarding Poland, on 10 December 2013, the Council decided under Article 126(8) of the Treaty that Poland had not taken effective action in compliance with the Council Recommendation of 21 June 2013 to correct its excessive deficit by 2014, and under Article 126(7) of the Treaty recommended Poland to put an end to the excessive deficit situation by 2015. In accordance with Article 5(1a) of Council Regulation (EC) No 1467/97, Poland reported on action taken in both the context of its convergence programme submitted on 15 April 2014 as well as in a dedicated report submitted on the same date.

Regarding Croatia, on 10 December 2013, having taken into account its report under Article 126(3) of the Treaty and having regard to the opinion of the Economic and Financial Committee in accordance with Article 126(4) of the Treaty, the Commission concluded that an excessive deficit existed in Croatia. The Commission therefore addressed such an opinion to Croatia and informed the Council accordingly. On 28 January 2014, considering that according to national plans and the Commission forecast deficits remained well above the 3% of GDP Treaty reference value in the period 2013-15 and that the debt ratio was expected to rise above 60% of GDP in 2014, increasing further over the forecast horizon up to 2015, the Council decided that an excessive deficit existed in Croatia in accordance with Article 126(6) of the Treaty and issued a recommendation under Article 126(7) of the Treaty to the country, with a view to end the excessive deficit situation by 2016. In accordance with Article 3(4a) of Council Regulation (EC) No 1467/97, Croatia reported on action taken in the context of its convergence programme submitted on 30 April 2014.

Following the submission of Member States' reports, the Commission has examined them to assess whether they have complied with their respective Article 126 (7) recommendation.

2. ASSESSMENT OF ACTION TAKEN

According to Regulation (EC) No 1467/97 and the Code of Conduct[1] 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 budgetary targets and the underlying improvement of its cyclically adjusted balance, net of one-off and other temporary measures, recommended by the Council.

The methodology for assessing effective action requires that the Commission first considers whether the Member State is compliant with the nominal target and the underlying improvement in the structural balance, as required in the EDP recommendation. If this is the case, the procedure is held in abeyance.

[1] "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", available at: http://ec.europa.eu/economy_finance/economic_governance/sgp/index_en.htm .

If the Member State fails to meet the headline deficit target or the required improvement in the structural balance, a careful analysis of the reasons of the shortfall is undertaken to assess whether the Member state has acted in compliance with the recommendation (or notice). The careful analysis builds on two complementary fiscal effort measures: (i) the 'top-down' approach, i.e. computing the change in the structural balance adjusted for the changes stemming from the revision of potential output growth, revenue windfalls/shortfalls and unexpected events; and (ii) the 'bottom-up' approach, i.e. estimating the budgetary impact of the individual fiscal measures implemented by the government. The careful analysis needs to be complemented by other relevant qualitative considerations that will allow the Commission to provide a qualified judgment on whether the Member States has taken enough policy actions to comply with the EDP recommendation (or notice). If the careful analysis indicates that the Member State concerned has delivered on its policy commitments, the assessment will conclude that effective action has been taken, giving the Council a possibility to extend the deadline, even if the headline deficit target has not been met. If the careful analysis shows that policy commitments have not been delivered, and the headline deficit target is not met, the assessment will conclude that effective action has not been taken and the procedure should be stepped up (with the possibility of setting a new correction deadline).

2.1. Assessment of action taken by Poland

According to the new Council recommendation issued on 10 December 2013, Poland was recommended to reach a headline deficit of 4.8% of GDP in 2013, 3.9% of GDP in 2014 and of 2.8% of GDP in 2015 (excluding the impact of the assets transfers from the second pillar pension system). Based on the macroeconomic forecast underlying the Council recommendation, this is consistent with an improvement of the structural balance of 1% of GDP in 2014 and 1.2% of GDP for 2015. Poland was also recommended to implement rigorously the measures it had already announced and adopted, while complementing them with additional measures to achieve a sustainable correction of the excessive deficit by 2015. Poland was given a deadline of 15 April 2014 to take effective action to comply with the recommendation and to report in detail on the consolidation strategy envisaged in order to achieve the targets. At the established deadline, the Polish authorities submitted a report to the Commission presenting the measures it had taken in response to the Council recommendation and outlining the consolidation strategy aimed at bringing an end to the situation of an excessive government deficit.

The 2013 headline deficit, at 4.3% of GDP, was lower than the recommended level of 4.8% of GDP. According to the Commission 2014 spring forecast, the general government balance is projected to reach a surplus of 5.7% of GDP in 2014. If this projection is adjusted to exclude the transfer of pension assets (in line with the statistical rules that will be in effect as of September 2014), the general government balance in 2014 stands at -3.6% of GDP, thus below the headline target set in the recommendation. For 2015, based on the no-policy-change assumption, the deficit is projected at 3.1% of GDP (excluding the impact of the asset transfer), thus above the recommended 2.8% target.

Based on Commission spring forecast, the change in the structural balance is expected to be just in line with the 1% recommended target in 2014 and, at 0.4% of GDP, below the target in 2015.

Table 1. Poland - comparison of budgetary projections

% of GDP	Headline budget balance			Change in the structural balance	
	2013	2014	2015	2014	2015
Commission 2014 spring forecast	-4.3	5.7	-2.9	1.0	0.4
Commission 2014 spring forecast - excluding the transfer of pension assets*	-4.3	-3.6	-3.1	1.0	0.4
Convergence Programme**	-4.3	5.8	-2.5	1.2	0.6
Target of the latest EDP recommendation*	-4.8	-3.9	-2.8	1.0	1.2

Notes:
* Nominal deficit corrected for the transfer of assets in relation with the pension reform (consistently with the formulation of the recommendation).
** Structural balance according to the programme as recalculated by the Commission on the basis of the programme scenario using the commonly agreed methodology

The Commission projections take into account the sufficiently specified measures announced by Poland in its report on effective action and convergence programme. Most of these measures had already been taken before the Council adopted the new recommendation under the EDP on 10 December 2013, and were already included in the Commission 2013 autumn forecast. According to the Commission's assessment, the additional measures taken since the time of the EDP recommendation are expected to have a marginal impact in 2014 and to reduce the deficit by 0.1% of GDP in 2015.

When corrected for the downward revision in potential growth as well as for revenue developments since the time of the Council recommendation, the adjusted structural improvement is estimated at 0.6% of GDP in 2014, below the effort required by the Council. This shortfall is confirmed by a bottom-up assessment which estimates the size of the additional fiscal effort in 2014 on the basis of the discretionary revenue measures and the expenditure developments between the baseline scenario underpinning the Council recommendation and the 2014 Commission spring forecast. It shows an effort of -0.1% of GDP, compared to the required 0.4% of GDP. In 2015, on the basis of the usual no-policy-change assumption, the adjusted change in the structural balance is projected at 0.1% of GDP, well below the 1.2% of GDP required by the revised EDP recommendation. This shortfall is confirmed in the bottom-up assessment which, projects an effort of -0.8% of GDP in 2015, well below the effort estimated as needed at the time of the recommendation

Table 2. Poland - comparison of adjusted change in the structural balance and fiscal efforts based on Commission 2014 spring forecast

% of GDP	Adjusted change of structural balance		Bottom-up	
	2014	2015	2014	2015
Commission 2014 spring forecast	0.6	0.1	-0.1	-0.8
EDP target	1.0	1.2	0.4	1.0

Given that Poland has met the recommended headline balance as well as the recommended change in the structural balance in 2014, the Commission considers that the procedure is to be held in abeyance. However, there are risks to a durable correction of the excessive deficit at the established deadline, as the fiscal effort measured by both the corrected change in the structural balance and the bottom-up assessment are well below the recommended level. In particular, for 2015, and prior to the presentation of the 2015 budget, the Commission services forecast the headline deficit to decline to 3.1% of GDP (excluding the transfer of pension assets) and the structural improvement to reach 0.4% of GDP, thus below the targets recommended by the Council. Therefore, the 2015 budget needs to include structural adjustment measures to ensure compliance with the Council recommendation.

2.2. Assessment of action taken by Croatia

The Council opened the Excessive Deficit Procedure for Croatia on 28 January 2014 and recommended correcting the excessive deficit by 2016. The EDP recommendation requires Croatia to reach a headline deficit target of 4.6% of GDP in 2014, 3.5% of GDP in 2015 and 2.7% of GDP in 2016.[2] This is consistent with an improvement in the structural balance of 0.5% of GDP in 2014, 0.9% of GDP in 2015 and 0.7% of GDP in 2016, and to adopt consolidation measures for an amount of 2.3% of GDP in 2014 and of 1.0% of GDP in 2015 and 2016, in order to reach the required adjustment of the structural balance. Croatia was given a deadline of 30 April 2014 to take effective action to comply with the recommendation and to report in detail on the consolidation strategy envisaged in order to achieve the targets. Croatia submitted a report on action taken in the context of its convergence programme.

Table 3. Croatia- comparison of budgetary projections

% of GDP	Headline budget balance		Change in the structural balance	
	2014	2015	2014	2015
Commission 2014 spring forecast	-3.8	-3.1	0.4	0.8
*p.m. Commission 2014 spring forecast - excluding the transfer of pension assets**	*-4.6*	*-3.8*	*0.4*	*0.8*
Convergence Programme**	-4.4	-3.5	-0.3	0.9
Target of the latest EDP recommendation	-4.6	-3.5	0.5	0.9

Notes:
* Nominal deficit corrected for the transfer of assets in relation with the pension reform.
** Structural balance according to the programme as recalculated by the Commission on the basis of the programme scenario using the commonly agreed methodology. The Convergence Programme uses different accounting methodologies for past and future years. This artificially and substantially (by at least 0.5% of GDP) reduces the improvement in the (recalculated) structural balance in 2014.

On the basis of current information and the Commission 2014 spring forecast, the general government deficit is projected to reach 3.8% of GDP in 2014 and 3.1% of GDP in 2015. If these projections are adjusted to exclude the transfer of pension assets (in line with the

[2] The targets are not corrected for the impact of the assets transfer related to the pension reform. However, with the introduction of ESA2010 in autumn 2014 this impact will be excluded from the figures which will form the basis of the assessment under the SGP as from then.

statistical rules that will be in effect as of September 2014), the government deficit is forecast at 4.6% and 3.8% of GDP in 2014 and 2015, respectively. The Commission services' baseline scenario does however not incorporate the full set of measures in the consolidation package, because of insufficient specification of some of the measures (such as savings on subsidies or social transfers) and some uncertainties about the accounting treatment of some measures (for instance, in the case of withdrawal of profits from state-owned enterprises). Nevertheless, with this projected adjustment, the nominal target set in the context of the EDP is expected to be attained in 2014, while in 2015 the nominal target would be missed by ¼% of GDP. The structural balance improves by 0.4% of GDP in 2014 and by 0.8% of GDP in 2015, with a small shortfall in both years compared to the improvement of 0.5% and 0.9% of GDP required in the EDP recommendation.

Table 4. Croatia - comparison of adjusted change in the structural balance and fiscal effort based on Commission 2014 spring forecast

% of GDP	Adjusted change of structural balance		Bottom-up	
	2014	2015	2014	2015
Commission 2014 spring forecast	0.2	0.8	2.3	1.1
EDP target	0.5	0.9	2.3	1.0

Proceeding with a careful analysis based on the adjusted change of structural balance and the bottom-up approach as required for the assessment of effective action, the former would show an improvement in 2014 of 0.2% of GDP and an effort of 0.8% of GDP for 2015. This would be below the requirement in both years, but only marginally so in 2015. At the same time, the bottom-up assessment of the fiscal effort is estimated to be delivered, both in 2014 and 2015, with measures amounting to 2.3% of GDP in 2014, in line with the requirement, and 1.1% of GDP in 2015, slightly above the recommended 1% of GDP. This is the reflection of the fact that the budgetary adjustment envisaged in the programme is underpinned by a large set of measures, including increases in social security and pensions contributions and expenditure savings on subsidies, intermediate consumption and social transfers. In the context of the careful analysis it should be considered that all of these measures were adopted after and in response to the January 2014 Council decision on the existence of excessive deficit. The authorities' strong commitment to adhere to the Council recommendation is also reflected in the fact that, after it became evident that the revision of the 2014 budget in March 2014 was not sufficient to meet the EDP recommendations, the authorities have taken additional measures of 0.4% of GDP.

In view of the fact that in 2014 the nominal target is expected to be attained, that the bottom-up approach shows that Croatia has taken the amount of measures deemed necessary to reach the structural targets spelled out in the EDP recommendation, and taking account of the careful analysis and other qualitative factors mentioned above, the Commission considers that the procedure for Croatia is to be held in abeyance. However, considering that in 2015, and prior to the presentation of the 2015 budget, the Commission services expect the headline balance and the structural improvement to be below the targets recommended by the Council, the 2015 budget needs to include structural adjustment measures to ensure compliance with the Council recommendation.

3. CONCLUSIONS

The Commission considers that Poland and Croatia have taken effective action and that no further steps in the excessive deficit procedure are needed at present. The Commission will continue to closely monitor budgetary developments in accordance with the Treaty and the SGP.

Annex. EDP related tables

Table A1. Adjustment of apparent structural effort for the revision in potential growth – details of calculation

PL	Potential GDP growth underlying the Council Recommendation (%)	Potential GDP growth at the time of assessment (%)	Forecast error (%)	Structural expenditure (% of potential GDP)	Correction coefficient α (% of nominal potential GDP)
	(1)	(2)	(3)=(1)-(2)	(4)	(5)=(3)*(4)/100
2014	2.5	3.2	-0.8	41.3	-0.3
2015	2.5	3.4	-0.9	40.7	-0.4

HR	Potential GDP growth underlying the EDP Recommendation (%)	Potential GDP growth at the time of assessment (%)	Forecast error (%)	Structural expenditure (% of potential GDP)	Correction coefficient α (% of nominal potential GDP)
	(1)	(2)	(3)=(1)-(2)	(4)	(5)=(3)*(4)/100
2014	-0.2	0.3	-0.5	44.6	-0.2
2015	0.6	0.6	0.0	45.0	0.0

Table A2. Adjustment of apparent structural effort for the revision in revenue shortfalls/windfalls – details of calculation

PL	Change in current revenues (yoy) (billions)		Discretionary current revenue measures (billions)		Nominal GDP growth assumptions (%)		change in output gap		Current revenues in year t-1 (billions)		Revenue gap (billions)*	Nominal GDP	Correction coefficient β (% of nominal GDP)
	recom.	assessment	recom.	assessment	recom.	assessment	recom.	assessment	recom.	assessment		assessment	
	(1)	(1')	(2)	(2')	(3)	(3')	(4)	(4')	(5)	(5')	(6)=[(1')-(2')-[(3')+(ε-1)*(4')/100]*(5')]-[(1)-(2)-[(3)+(ε-1)*(4)/100]*(5)]	(7)	(8)=100*(6)/(7)
2014	22.7	27.3	6.8	9.3	0.0	0.0	0.0	0.0	582.7	597.3	2.0	1705.5	0.1
2015	32.1	34.9	5.9	6.5	0.0	0.1	0.4	0.1	605.4	624.6	-0.3	1791.0	0.0
	*revenue elasticity (ε): 0.78												

HR	Change in current revenues (yoy) (billions)		Discretionary current revenue measures (billions)		Nominal GDP growth assumptions (%)		change in output gap		Current revenues in year t-1 (billions)		Revenue gap (billions)*	Nominal GDP	Correction coefficient β (% of nominal GDP)
	(1)	(1')	(2)	(2')	(3)	(3')	(4)	(4')	(5)	(5')	(6)=[(1')-(2')-[(3')+(ε-1)*(4')/100]*(5')]-[(1)-(2)-[(3)+(ε-1)*(4)/100]*(5)]	(7)	(8)=100*(6)/(7)
2014	3.1	4.0	2.2	5.9	0.0	0.0	0.7	-0.9	131.0	133.9	-0.2	328.9	-0.1
2015	5.2	4.9	0.0	1.2	0.0	0.0	0.6	0.1	134.0	137.8	0.0	335.0	0.0
	*revenue elasticity (ε): 0.86												