Specifications on the implementation of the Stability and Growth Pact

and

Guidelines on the format and content of Stability and Convergence Programmes

Consolidated version, endorsed by the ECOFIN Council on 7 September 2010

TABLE OF CONTENTS

SECTION I – SPECIFICATIONS ON THE IMPLEMENTATION OF THE STABILITY AND GROWTH PACT *Page 4*

A. THE PREVENTIVE ARM OF THE STABILITY AND GROWTH PACT *Page 4*

1) The Medium term budgetary objective (MTO) *Page 4*

2) The adjustment path toward the medium-term budgetary objective and deviations from it *Page 5*

3) Commission policy advice and warning *Page 6*

B. THE EXCESSIVE DEFICIT PROCEDURE *Page 6*

1) Commission report under Article 126(3) TFEU *Page 6*

2) The decision on the existence of an excessive deficit *Page 7*

3) The correction of an excessive deficit *Page 8*

4) Abrogation of Council decisions in the context of the EDP for Member States having implemented multi-pillar pension reforms *Page 9*

SECTION II - GUIDELINES ON THE FORMAT AND CONTENT OF STABILITY AND CONVERGENCE PROGRAMMES *Page 10*

1) Status of the programme and of the measures *Page 10*

2) Content of Stability and Convergence Programmes *Page 10*

ANNEX 1 - MODEL STRUCTURE FOR THE STABILITY AND CONVERGENCE PROGRAMMES *Page 14*

ANNEX 2 - TABLES TO BE CONTAINED IN THE STABILITY AND CONVERGENCE PROGRAMMES *Page 15*

INTRODUCTION

This Opinion updates and replaces the opinion of the Economic and Financial Committee on the content and format of the Stability and Convergence Programmes, endorsed by the Ecofin Council on 10 November 2009.

The Stability and Growth Pact fully entered into force on 1 January 1999 and consists of a rules-based framework with both preventive and corrective elements. It initially consisted of Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure and the Resolution of 17 June 1997 on the Stability and Growth Pact. On 20 March 2005 the Council adopted a report entitled “Improving the implementation of the Stability and Growth Pact”. The report was endorsed by the European Council in its conclusions of 22 March 2005, which stated that the report updates and complements the Stability and Growth Pact, of which it is now an integral part. On 27 June 2005 the Pact was complemented by two additional Regulations 1055/05 and 1056/05, amending the Regulations 1466/97 and 1467/97.

The Stability and Growth Pact is an essential part of the macroeconomic framework of the Economic and Monetary Union, which contributes to achieving macroeconomic stability in the EU and safeguarding the sustainability of public finances. A rules-based system is the best guarantee for commitments to be enforced and for all Member States to be treated equally. The two nominal anchors of the Stability and Growth Pact - the 3% of GDP reference value for the deficit ratio and the 60% of GDP reference value for the debt ratio - and the medium-term budgetary objectives are the centrepiece of multilateral surveillance.

Member States, the Commission and the Council are committed to deliver on their respective responsibilities, applying the Treaty and the Stability and Growth Pact in an effective and timely manner. In addition, since effectiveness of peer support and peer pressure is an integral part of the Stability and Growth Pact, the Council and the Commission are expected to motivate and make public their positions and decisions at all appropriate stages of the procedure of the Stability and Growth Pact. Member States are expected to take into account guidance and recommendation(s) from the Council in particular when preparing their budgets, and to appropriately involve national Parliaments in the EU procedures, taking into account national parliamentary and budgetary procedures.

In order to enhance ownership of the EU budgetary framework, national budgetary rules should be complementary to the Stability and Growth Pact. Without prejudice to the balance between national and Community competences, their implementation could be discussed at European level in the context of the Stability and Convergence Programmes. In the same vein, governance arrangements at national level should complement the EU framework. National institutions could play a more prominent role in budgetary surveillance to enhance enforcement through national public opinion and complement the economic and policy analysis at EU level. In particular, Member States could establish an economic council of wise people who would advise on the main macro-economic projections.

These Guidelines for the implementation of the Stability and Growth Pact consist of 2 sections. The first section elaborates on the implementation of the Stability and Growth Pact. The second section consists of guidelines on the content and format of the stability and convergence programmes.

SECTION I

SPECIFICATIONS ON THE IMPLEMENTATION OF THE STABILITY AND GROWTH PACT

A. THE PREVENTIVE ARM OF THE STABILITY AND GROWTH PACT

1) The Medium term budgetary objective (MTO)

Definition of the MTO

The MTO is defined in cyclically adjusted terms, net of one-off and other temporary measures. The reference method for the estimation of potential output is the one adopted by the Council on 12 July 2002.[1] One-off and temporary measures are measures having a transitory budgetary effect that does not lead to a sustained change in the intertemporal budgetary position.[2]

The MTO pursues a triple aim:

(i) *providing a safety margin with respect to the 3% of GDP deficit limit.* This safety margin is assessed for each Member State taking into account past output volatility and the budgetary sensitivity to output fluctuations.

(ii) *ensuring rapid progress towards sustainability.* This is assessed against the need to ensure the convergence of debt ratios towards prudent levels taking into account the economic and budgetary impact of ageing populations.

(iii) *taking (i) and (ii) into account, allowing room for budgetary manoeuvre, in particular taking into account the needs for public investment.*

The MTOs are differentiated for individual Member States to take into account the diversity of economic and budgetary positions and developments as well as of fiscal risk to the sustainability of public finances, also in face of prospective demographic changes. The country-specific MTOs may diverge from the requirement of a close to balance or in surplus position.

Specifically, the country-specific MTOs should take into account three components: i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure. This implies a partial frontloading of the budgetary cost of ageing irrespective of the current level of debt. In addition to these criteria, MTOs should provide a safety margin with respect to the 3% of GDP deficit reference value and, for euro area and ERM II Member States, in any case not exceed a deficit of 1% of GDP. The examination of the country-specific MTOs by the Commission and the Council in the context of the assessment of Stability and Convergence programmes should indicate whether they adequately reflect the objectives of the Stability and Growth Pact on the basis of the above criteria. Potential growth and the budgetary cost of ageing should be assessed in a long-term perspective on the basis of the projections produced by the Working Group on Ageing attached to the Economic Policy Committee. MTOs can be revised when a major structural reform with impact on the cost of ageing is implemented and in any case every four years preferably after a new set of projections is produced by the Working Group.

Member States may present more ambitious MTOs than implied by these criteria if they feel their circumstances call for it.

For Member States outside of the euro area and not participating in ERM II, country-specific MTOs would be defined with a view to ensuring the respect of the triple aim mentioned above.

Procedure for defining and revising the MTOs

In order to ensure a consistent application of the principles mentioned above for defining the country-specific MTOs, regular methodological discussions take place in the Economic and Financial Committee.

Taking into account the results of these discussions, Member States present their MTO in their Stability or Convergence programme. The MTOs are examined by the Commission and the Council in the context of the assessment of the Stability and Convergence Programmes. In accordance with Article 99(3) of the Treaty and Article 5(2) of Regulation 1466/97, where

[1] Due to data problems, a different method may be used for the estimation of potential output in the case of recently acceded member states (RAMS). The method used should be agreed by the Economic Policy Committee on the basis of a proposal of the Output Gap Working Group.

[2] Examples of one-off and temporary measures are the sales of non-financial assets; receipts of auctions of publicly owned licenses; short-term emergency costs emerging from natural disasters; tax amnesties; revenues resulting from the transfers of pension obligations.

the Council considers that the MTO presented in a Stability or Convergence programme should be strengthened, it shall, in its opinion, invite the Member State concerned to adjust its programme.

The MTOs could be revised when a major reform is implemented and in any case every four years, in order to reflect developments in government debt, potential growth and fiscal sustainability.

2) The adjustment path toward the medium-term budgetary objective and deviations from it

Fiscal behaviour over the cycle and adjustment path toward the MTO

Member States should achieve a more symmetrical approach to fiscal policy over the cycle through enhanced budgetary discipline in periods of economic recovery, with the objective to avoid pro-cyclical policies and to gradually reach their medium term objective, thus creating the necessary room to accommodate economic downturns and reduce government debt at a satisfactory pace, thereby contributing to the long-term sustainability of public finances. The presumption is to use unexpected extra revenues for deficit and debt reduction.

- Member States that have already reached their MTO could let automatic stabilisers play freely over the cycle. They should in particular avoid pro-cyclical fiscal policies in 'good times'.

- Member States that have not yet reached their MTO should take steps to achieve it over the cycle. Their adjustment effort should be higher in good times; it could be more limited in bad times. In order to reach their MTO, Member States of the euro zone or of ERM-II should pursue an annual adjustment in cyclically adjusted terms, net of one-offs and other temporary measures, of 0.5% of GDP as a benchmark.

Member States that do not follow the required adjustment path will explain the reasons for the deviation in the annual update of their Stability/Convergence Programme.

Based on the principles mentioned above and on the explanations provided by Member States, the Commission and the Council, in their assessments of the Stability or Convergence Programmes, examine whether the adjustment path towards the medium-term budgetary objective is appropriate. In particular, they examine whether a sufficient adjustment effort is made in economic good times, and take into account that the effort may be more limited in economic bad times.

In case the Council considers that the adjustment path towards the MTO should be strengthened , it shall, in accordance with Article 99(3) of the Treaty and Article 5(2) of Regulation 1466/97, invite the Member State concerned to adjust its programme.

Definition of economic 'good times'

Economic 'good times' should be identified as periods where output exceeds its potential level, taking into account tax elasticities.

Given the uncertainty surrounding output gap levels' estimates, the change in the output gap could also be considered, especially when the output gap is estimated to be close to zero. For instance, periods where the output gap is slightly negative but moving rapidly towards positive values could be considered as 'good times'. Symmetrically, periods where the output gap is slightly positive but moving rapidly towards negative values could not be considered as 'good times'.

The identification of periods of economic 'good times' should be made after an overall economic assessment.

The reference for the estimation of potential output is the methodology adopted by the Council on 12 July 2002.[3] The reference to 'tax elasticities' should be understood as the overall elasticity of taxes to GDP, resulting from the influence of economic factors (fiscal leads and lags, supply and demand composition of growth), abstracting from the implementation of discretionary measures.

Structural reforms

In order to enhance the growth oriented nature of the Pact, structural reforms will be taken into account when defining the adjustment path to the medium-term objective for countries that have not yet reached this objective and in allowing a temporary deviation from this objective for countries that have already reached it.

Only major reforms that have a verifiable positive impact on the long-term sustainability of public finances will be taken into account. This includes reforms with direct long-term cost-saving effects and reforms raising potential growth. For instance, major health, pension and labour market reforms will be considered.

[3] See footnote 1.

Special attention will be paid to pension reforms introducing a multi-pillar system that includes a fully funded pillar, which have a direct negative impact on the general government deficit (as defined in Article 1 of Regulation 3605/93). This impact stems from the fact that revenue, which used to be recorded as government revenue, is diverted to a pension fund, which is fully-funded and classified in a sector other than general government, and that some pensions and other social benefits, which used to be government expenditure, will be, after the reform, paid by the pension scheme.[4] In this specific case, the allowed deviation from the MTO should reflect the net cost of the reform to the publicly managed pillar, provided the deviation remains temporary and an appropriate safety margin to the reference value is preserved. The net cost of the reform is measured as its direct impact on the general government deficit.

Only adopted reforms should be considered, provided that sufficient, detailed information is provided in the Stability and Convergence Programmes (see Section II). The budgetary effects of the reforms over time are assessed by the Commission and the Council in a prudent way, making due allowance for the margin of uncertainties associated to such an exercise.

Major structural reforms as identified above will be taken into account when defining the adjustment path to the medium-term objective for countries that have not yet reached this objective and in allowing a temporary deviation from this objective for countries that have already reached it, with the clear understanding that:

(i) *a safety margin to ensure the respect of the 3% of GDP reference value for the deficit is guaranteed.* This safety margin will be assessed for each Member State taking into account past output volatility and the budgetary sensitivity to output fluctuations.

(ii) *the budgetary position is expected to return to the MTO within the period covered by the Stability or Convergence Programme.* For this purpose, the period under consideration will be limited to - at most - the four years following the year of the presentation of the programme.

In case a temporary deviation from the medium-term objective or the adjustment path toward it is allowed, this should be specified in the Council Opinion on the Stability/Convergence Programme.

[4] For more information on the classification of pension schemes, see Eurostat decision on the "Classification of funded pension schemes in case of government responsibility or guarantee" of 2 March 2004.

3) Commission policy advice and early warning

The Commission will issue policy advice to encourage Member States to stick to their adjustment path. Such policy advice, given in accordance with Article 211, second indent, of the Treaty, will be replaced by warnings in accordance with Article III-179 (4) of the Constitution as soon as it becomes applicable. The Commission policy advice and warnings are made public. The Commission continues to have the possibility to propose recommendations for the Council to issue an early warning, in accordance with Article 99 (4) of the Treaty and Article 6(2), 6(3), 10(2) and 10(3) of Regulation (EC) No 1466/97.

B. THE EXCESSIVE DEFICIT PROCEDURE

1) Preparation of a Commission report under Article 104(3) in case of non-compliance with the deficit criterion

The Commission will always prepare a report under Article 104 (3) of the Treaty when a reported or planned deficit exceeds 3% of GDP. The Commission may, in accordance with Article 104 (3), also prepare a report notwithstanding the fulfilment of the requirements under the criteria laid down in Article 104 (2)(a) of the Treaty if it is of the opinion that there is a risk of an excessive deficit in a Member State.

The Commission shall examine in its report if one or more of the exceptions foreseen in Article 104(2)(a) apply. In particular, the Commission shall consider whether the deficit ratio has declined substantially and continuously and reached a level that comes close to the reference value.

The Commission shall also consider whether the excess over the reference value is only exceptional and temporary and whether the ratio remains close to the reference value. In order to be considered as exceptional, the excess has to result from an unusual event outside the control of the Member State concerned and with a major impact on the financial position of the general government, or it has to result from a 'severe economic downturn'. The Commission and the Council may consider an excess over the reference value resulting from a 'severe economic downturn' as exceptional in the sense of the second indent of Article 104 (2) (a) of the Treaty if the excess over the reference value results from a negative annual GDP volume growth rate or from an accumulated loss of output during a protracted period of very low annual GDP volume growth relative to its potential. The indicator for assessing accumulated loss of output is the output gap, as calculated according to the method agreed by the Council on 12 July 2002.[5] The excess over the reference value shall be considered as temporary if the forecasts provided by the Commission indicate that the deficit will fall below the reference value following the end of the unusual event or the severe economic downturn.

The Commission report under Article 104(3) shall also take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors.

The Commission report should appropriately reflect developments in the medium-term economic position (in particular potential growth, prevailing cyclical conditions, the implementation of policies in the context of the Lisbon agenda and policies to foster R&D and innovation) and in the medium-term budgetary position (in particular, fiscal consolidation efforts in ‘good times’, debt sustainability, public investment and the overall quality of public finances). Furthermore, due consideration will be given to any other factors which, in the opinion of the Member State concerned, are relevant in order to comprehensively assess in qualitative terms the excess over the reference value. To this end, the Member State concerned may put forward to the Council and to the Commission the specific factors that it considers relevant, in due time for the preparation of the report under Article 104(3) and as a rule within one month of the reporting dates established in Article 4 (2) and (3) of Regulation (EC) No 3605/93. The Member State shall provide the information necessary for the Commission and the Council to make a comprehensive assessment of the budgetary impact of these factors. In that context, special consideration will be given to budgetary efforts towards increasing or maintaining at a high level financial contributions to fostering international solidarity and to achieving European policy goals, notably the unification of Europe if it has a detrimental effect on the growth and fiscal burden of a Member State. A balanced overall assessment has to encompass all these factors.

The Commission report will give due consideration to the implementation of pension reforms introducing a multi-pillar system that includes a fully funded pillar, if these reforms have a direct negative impact on the general government deficit (as defined in Article 1 of Regulation 3605/93. This impact stems from the fact that revenue, which used to be recorded as government revenue, is diverted to a pension fund, which is fully-funded and classified in a sector other than general government, and that some pensions and other social benefits, which used to be government expenditure will be, after the reform, paid by the pension scheme. In particular, the Commission report will examine the net cost of the reform to the publicly managed pillar. The net cost of the reform is measured as its direct impact on the general government deficit.

2) Increasing the focus on debt and sustainability

In line with the provisions of the Treaty, the Commission has to examine compliance with budgetary discipline on the basis of both the deficit and the debt criteria. The Council has agreed that there should be increased focus on debt and sustainability, and reaffirmed the need to reduce government debt to below 60 % of GDP at a satisfactory pace, taking into account macroeconomic conditions. The higher the debt to GDP ratios of Member States, the greater must be their efforts to reduce them rapidly.

The debt surveillance framework and the excessive deficit procedure should be strengthened by applying the concept of “sufficiently diminishing and approaching the reference value at a satisfactory pace” for the debt ratio in qualitative terms, by taking into account macroeconomic conditions and debt dynamics, including the pursuit of appropriate levels of primary surpluses as well as other measures to reduce gross debt and debt management strategies and the relationship between the evolution of the deficit and the evolution of the general government gross debt.

The Commission will always prepare a report on the basis of Article 104(3) of the Treaty, in which it shall examine if one or more of the exceptions foreseen respectively in Article 104(2)(a) and (b) apply.

For countries in which the debt ratio is above the reference value, the Council will formulate recommendations on the debt dynamics in its opinions on the Stability and Convergence Programmes.

3) The decision on the existence of an excessive deficit

If the double condition of the overarching principle – that, before the relevant factors mentioned in Article 2 (3) of Regulation 1467/97 are taken into account, the general government deficit remains close to the reference value and its excess over the reference value is temporary – is fully met, the relevant factors assessed in the Commission report under Article 104(3) will also be taken into account in the steps leading to the decision on the existence of an

[5] See footnote 1.

excessive deficit, foreseen in paragraphs (4), (5) and (6) of Article 104 of the Treaty**.** The balanced overall assessment to be made by the Council in accordance with Article 104(6) shall encompass all these factors.

In the case of Member States where the deficit exceeds the reference value, while remaining close to it, and where this excess reflects the direct impact on the general government deficit (as defined in Article 1 of Regulation 3605/93) stemming from the implementation of a pension reform introducing a multi-pillar system that includes a fully funded pillar, the Commission and the Council shall also consider the cost of the reform to the publicly managed pillar when assessing developments in EDP deficit figures. This impact stems from the fact that revenue, which used to be recorded as government revenue, is diverted to a pension fund, which is fully-funded and classified in a sector other than general government, and that some pensions and other social benefits, which used to be government expenditure, will be, after the reform, paid by the pension scheme. Consideration to the net cost of the reform will be given for the initial five years after a Member State has introduced a fully-funded system, or five years after 2004 for Member States that have already introduced such a system. Furthermore, it will also be regressive, i.e. during a period of five years, consideration will be given to 100, 80, 60, 40 and 20 percent of the net cost of the reform to the publicly managed pillar. The net cost of the reform is measured as its direct impact on the general government deficit.

The Council shall decide on the existence of an excessive deficit in accordance with Article 104 (6) of the Treaty, on the basis of a Commission recommendation, as a rule within four months of the reporting dates established in Article 4 (2) and (3) of Regulation (EC) No 3605/93. The Council may decide later in the cases in which the budgetary statistical data have not been validated by the Commission (Eurostat) shortly after the reporting dates established in Regulation (EC) No 3605/93.

4) The correction of an excessive deficit

Minimum fiscal effort for countries in excessive deficit and initial deadline for its correction

The Council recommendations under Article 104 (7) and notices under Article 104 (9), based on recommendations of the Commission, will request that the Member State concerned achieves a minimum annual improvement in its cyclically adjusted balance net of one-off and temporary measures of at least 0.5% of GDP as a benchmark, in order to correct the excessive deficit within the deadline set in the recommendation.

As a rule, the initial deadline for correcting an excessive deficit should be the year after its identification and thus, normally, the second year after its occurrence. This deadline should be set taking into account the minimum adjustment, in cyclically adjusted terms net of one-off and other temporary measures, requested by the Council. If this effort seems sufficient to correct the excessive deficit in the year following its identification, the initial deadline needs not to be set beyond that year.

In case of special circumstances, the initial deadline for correcting an excessive deficit would be set, as a rule, one year later, i.e. the second year after its identification and thus normally the third year after its occurrence. The determination of the existence of such circumstances will take into account a balanced overall assessment of the factors mentioned in the report under Article 104 (3).

Longer deadlines could be set for new and future Member States, i.e. in the case of Members States being placed in excessive deficit immediately following their accession. Longer deadlines could also be set for Member States implementing pension reforms introducing a multi-pillar system that includes a fully funded pillar.

Clarifying the conditions for abeyance

Following the expiry of the six month period following the adoption of a recommendation under Article 104(7) or the four months period following the adoption of a notice under Article 104(9), the Commission shall assess whether the Member State concerned has acted in compliance with the recommendation or notice. This assessment should consider whether the Member State concerned has publicly announced or taken measures that seem sufficient to ensure adequate progress towards the correction of the excessive deficit within the time limits set by the Council.

In case it appears that the Member State concerned has not acted in compliance with the recommendation or notice, the following step of the procedure provided by Article 104 of the Treaty, as clarified by Regulation (EC) No 1467/97, shall be activated.

If the Commission considers that the Member State has acted in compliance with the recommendation or notice, it shall inform the Council accordingly, and the procedure shall be held in abeyance. If, thereafter, it appears that action by the Member State concerned is not being implemented or is proving to be inadequate and if the possibility of repeating the same step does not apply, the following step of the procedure provided by Article 104 of the Treaty, as clarified by Regulation (EC) No 1467/97, shall be immediately activated. When considering whether the following step of the procedure should be activated, the Commission and the Council should take into account whether the measures required in the recommendation or notice are fully implemented and whether other budgetary variables under the control of the government are developing in line with what was assumed in the recommendation or notice.

In the specific case of recommendations or notices which have set a deadline for the correction of the excessive deficit more than one year after its identification, the assessment made by the Commission after the expiry of the six month period following the adoption of a recommendation under Article 104(7) or the four month period following a notice under Article 104(9) 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. The Commission should, during the period of abeyance, assess whether the measures already announced or taken are being adequately implemented and whether additional measures are announced and implemented in order to ensure adequate progress toward the correction of the excessive deficit within the time limits set by the Council.

Clarifying the concept of effective action and repetition of steps in the excessive deficit procedure

If effective action has been taken in compliance with a recommendation under Article 104(7) (or notice under Article 104 (9)) of the Treaty and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that recommendation or notice, the Council may decide, on a recommendation from the Commission and before taking into account the relevant factors mentioned in Article 2 (3) of Regulation 1467/97, to adopt a revised recommendation under Article 104(7) (or notice under Article 104 (9)) of the Treaty. The revised recommendation (or notice), then taking into account the relevant factors mentioned in Article 2 (3) of Regulation 1467/97, may notably extend the deadline for the correction of the excessive deficit by one year.

A Member State should be considered to have taken ‘effective action’ if it has acted in compliance with the recommendation or notice, regarding both the implementation of the measures required therein and budgetary execution. The assessment 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 shortfall would be made.

The occurrence of unexpected adverse economic events with major unfavourable budgetary effects shall be assessed against the economic forecast underlying the Council recommendation or notice.

5) Abrogation of Council decisions in the context of the EDP for Member States having implemented multi-pillar pension reforms

Abrogation of Council decisions under paragraphs (6) to (9) and (11) of Article 104 of the Treaty is possible only if the general government deficit has declined substantially and continuously and has reached a level that comes close to the reference value.

The Commission and the Council, when considering under Article 104 (12) whether some or all of the Council decisions under Article 104 (6) to (9) and (11) should be abrogated, consider carefully an excess close to the deficit reference value which reflects the implementation of a pension reform introducing a multi-pillar system that includes a fully-funded pillar.

Consideration to the net cost of the reform will be given for the initial five years after a Member State has introduced a fully-funded system, or five years after 2004 for Member States that have already introduced such a system.[6] Furthermore, it will also be regressive, i.e. during a period of five years, consideration will be given to 100, 80, 60, 40 and 20 percent of the net cost of the reform to the publicly managed pillar. The net cost of the reform is measured as its direct impact on the general government deficit (as defined in Article 1 of Regulation 3605/93). This impact stems from the fact that revenue, which used to be recorded as government revenue, is diverted to a pension fund, which is fully-funded and classified in a sector other than general government, and that some pensions and other social benefits, which used to be government expenditure, will be, after the reform, paid by the pension scheme.

This implies in particular that for those Member States that already have implemented such reforms, it will be considered for 100% in 2005, 80% in 2006, 60% in 2007, 40% in 2008 and 20% in 2009. For reforms implemented after 2005, the net impact of such reforms will be considered accordingly. For

[6] Up to the March 2007 notification, these provisions do not apply to Member States that benefit from the special treatment granted by Eurostat for the implementation of the 2 March 2004 decision on the classification of second-pillar funded pension schemes. See Eurostat News Releases No 30/2004 of 2 March 2004 and No 117/2004 of 23 September 2004.

example, in the case of a Member State that would implement such a reform in 2007, the net budgetary impact of the reform will be considered for 100% in 2007, 80% in 2008, 60% in 2009, 40% in 2010 and 20% in 2011. The Member State shall provide the information necessary for the Commission to assess the net budgetary impact of the reform.

SECTION II

GUIDELINES ON THE FORMAT AND CONTENT OF STABILITY AND CONVERGENCE PROGRAMMES

The Stability and Growth Pact requires Member States to submit Stability or Convergence Programmes and updates thereof, which are at the basis of the Council's surveillance of budgetary positions and its surveillance and co-ordination of economic policies. The Council may, on a recommendation from the Commission, and after consulting the Economic and Financial Committee, deliver an opinion on each of the updated programmes and, if it considers that its objectives and contents should be strengthened, invite the Member State concerned to adjust its programme.

Member States are expected to take the corrective action they deem necessary to meet the objectives of their Stability or Convergence Programmes, whenever they have information indicating actual or expected significant divergence from those objectives.

The submission and assessment of Stability and Convergence Programmes is an important component of the "European Semester" of economic policy coordination and surveillance. Under the European Semester, the Commission and the Council shall assess Stability and Convergence Programmes before key decisions on the national budgets for the following years are taken, to provide policy advice on fiscal policy intentions. Member States shall align the timing of submissions and assessments of Stability and Convergence Programmes and National Reform Programmes.[7]

Under the European Semester the policy surveillance and coordination cycle starts early in the year with a horizontal review under which the European Council, based on input from the Commission and the Council, identifies the main economic challenges facing the EU and the euro area and give strategic guidance on policies. Member States are expected to take into account the horizontal guidance by the European Council when preparing their Stability and Convergence Programmes and justify any departure from it. Similarly, the Commission and Council are expected to take due account of the guidance from the European Council when assessing the individual programmes.

In view of the strengthened role of the Stability and Convergence Programmes in the process of multilateral surveillance under the European Semester, it is important that their information content is suitable and allows for comparison across Member States. Whilst acknowledging that the programmes are the responsibility of national authorities and that the possibilities and practices differ across countries, Council Regulation (EC) No 1466/97 as amended by Council Regulation (EC) No 1055/05 sets out the essential elements of these programmes. In particular, Stability and Convergence Programmes include the necessary information for a meaningful discussion on fiscal policy for the short and the medium term, including a full fledged multi-annual macroeconomic scenario, projections for the main government finances variables and their main components, and a description and quantification of the envisaged budgetary strategy.

The experience gathered during the first years of implementation of the Pact with the Stability and Convergence Programmes shows that guidelines on the content and format of the programmes not only assist the Member States in drawing up their programmes, but also facilitate their examination by the Commission, the Economic and Financial Committee and the Council, thus providing for a consistent implementation of the Stability and Growth Pact.

The guidelines set out below should be considered as a code of good practice and checklist to be used by Member States in preparing Stability or Convergence Programmes. Member States are expected to follow the guidelines as far as possible, and to justify any departure from them.

1) Status of the programme and of the measures

Each programme mentions its status in the context of national procedures, notably with respect to the national Parliament. The programme also indicates whether the Council opinion on the previous programme has been presented to the national Parliament.

The state of implementation of the measures (enacted versus planned) presented in the programme should be specified.

[7] In the case of the UK, which has a different fiscal year, submission will follow the presentation of the Spring Budget and be as close as possible to its publication.

2) Content of Stability and Convergence Programmes

In order to facilitate comparison across countries, Member States are expected, as far as possible, to follow the model structure for the programmes in Annex 1. The standardisation of the format and content of the programmes along the lines set below will substantially improve the conditions for equality of treatment.

The quantitative information should be presented following a standardised set of tables (Annex 2). Member States should endeavour to supply all the information in these tables. The tables could be complemented by further information wherever deemed useful by Member States.

In addition to the guidelines set out below, the programmes should provide information on the consistency with the broad economic policy guidelines of the budgetary objectives and the measures to achieve them, as well as on the measures to enhance the quality of public finances and to achieve long-term sustainability.

Objectives and their implementation

Member States will present in their Stability and Convergence Programmes budgetary targets for the general government balance in relation to the MTO, and the projected path for the debt ratio. Convergence programmes shall also present the medium-term monetary policy objectives and their relationship to price and exchange rate stability.

Member States, when preparing the first update of their Stability or Convergence Programme after a new government has taken office, are invited to show continuity with respect to the budgetary targets endorsed by the Council on the basis of the previous update of the Stability/Convergence Programme and - with an outlook for the whole legislature - to provide information on the means and instruments envisaged to reach these targets by setting out its budgetary strategy.

Member States will provide in their Stability or Convergence Programme an update of the fiscal plans for the year of submission of the programme, based on the April notification, including a description and quantification of the policies and measures. The Stability or Convergence Programme will explain revisions of general government balance and expenditure targets set in the programmes submitted in year t-1.

To permit a comprehensive understanding of the path of the government balance and of the budgetary strategy in general, information should be provided on expenditure and revenue ratios and on their main components, as well as on one-off and other temporary measures. To permit a comprehensive understanding of the path of the debt ratio, information should be provided, to the extent possible, on components of the stock-flow adjustment, such as privatisation receipts and other financial operations.

The budget balances should be broken down by sub-sector of general government (central government, state government for Member States with federal or quasi-federal institutional arrangements, local government and, social security).

Assumptions and data

Stability and Convergence programmes should be based on realistic and cautious macroeconomic forecasts. The Commission forecasts can provide an important contribution for the coordination of economic and fiscal policies. Member States are free to base their Stability/Convergence Programmes on their own projections. However, significant divergences between the national and the Commission services' forecasts should be explained in some detail. This explanation will serve as a reference when forecast errors are assessed ex post.

The programmes should present the main assumptions about expected economic developments and important economic variables that are relevant to the realisation of their budgetary plans, such as government investment expenditure, real GDP growth, employment and inflation. The assumptions on real GDP growth should be underpinned by an indication of the expected demand contributions to growth. The possible upside and downside risks to the outlook should be brought out.

Furthermore, the programmes should provide sufficient information about GDP developments to allow an analysis of the cyclical position of the economy and the sources of potential growth. The outlook for sectoral balances and, especially for countries with a high external deficit, the external balance should be analysed.

As regards external macroeconomic developments, euro area Member States and Member States participating in ERM II in particular should use the "common external assumptions" on the main extra-EU variables used by the Commission in its spring forecast, which shall be provided in due time, or, for comparability reasons, present sensitivity analysis based on the common assumptions for these variables when the differences are significant. The assumptions are to be provided in due time by the Commission services (after consultation with national experts), on the basis of the final table in Annex 2, for discussion by the EFC.

Assumptions about interest rates and exchange rates, if not presented in the programme, should be provided to the Commission services to allow for the technical assessment of the programmes.

In order to facilitate the assessment, the concepts used shall be in line with the standards established at European level, notably in the context of the European system of accounts (ESA). The programmes should ensure the formal and substantial consistency of the required information on budgetary aggregates and economic assumptions with ESA concepts. This information may be complemented by a presentation of specific accounting concepts that are of particular importance to the country concerned.

Measures, structural reforms and long-term sustainability

The programmes should describe the budgetary and other economic policy measures being taken, envisaged or assumed to achieve the objectives of the programme, and, in the case of the main budgetary measures, an assessment of their quantitative effects on the general government balance. Measures having significant 'one-off' effects should be explicitly identified. The further forward the year of the programme, the less detailed the information could be, but could contain quantified examples of measures that would allow reaching the programme targets.

However, in order to allow a meaningful discussion the programmes should provide concrete indications on the budgetary strategy for year t+1, including preliminary projections under unchanged policy and/or targets for the general government balance, expenditure and revenue and their main components, and a description and quantification of the policies taken, envisaged or assumed to reach the fiscal targets. Should the Council consider that the information provided in the programme is insufficient, it shall, in its opinion, invite the Member State concerned to submit a revised programme, in line with the provisions of Articles 5(2) and 8(2) of regulation 1466/97.

Structural reforms should be specifically analysed when they are envisaged to contribute to the achievement of the objectives of the programme. In particular, given the relevance of 'major structural reforms' in defining the adjustment path to the medium-term objective for Member States that have not yet reached it and allowing a temporary deviation from the MTO for Member States that have already reached it (see Section I), the programmes should include comprehensive information on the budgetary and economic effects of such reforms. Programmes should notably include a detailed quantitative cost-benefit analysis of the short-term costs – if any – and of the long-term benefits of the reforms from the budgetary point of view. They should also analyse the projected impact of the reforms on economic growth over time while explaining the used methodology.

The programmes should also provide information on measures taken or envisaged to improve the quality of public finances on both the revenue and expenditure side (e.g. tax reform, value-for-money initiatives, measures to improve tax collection efficiency and expenditure control).

The programmes could further include information on the implementation of existing national budgetary rules (expenditure rules, etc.) as well as on other institutional features of the public finances, in particular budgetary procedures and public finance statistical governance.

Finally, the programmes should outline the countries strategies to ensure the sustainability of public finances, especially in light of the economic and budgetary impact of ageing populations.

The Working Group on Ageing (AWG) attached to the Economic Policy Committee (EPC) is responsible for producing common budgetary projections on: public spending on pensions; health-care; long-term care; education; unemployment transfers; and where possible and relevant, age-related revenues, such as pension contributions. These common projections will provide the basis for the assessment by the Commission and the Council of sustainability of the Member States' public finances within the context of the SGP. They should be included in the programmes.

The programmes should include all the necessary additional information, both of qualitative and quantitative nature, so as to enable the Commission and the Council to assess the sustainability of Member States' public finances based on current policies. To this end, information included in programmes should focus on new relevant information that is not fully reflected in the latest common EPC projections. For example, Member States might want to include information on the latest demographic trends and major policy changes in pension and health-care systems. Programmes should clearly distinguish between measures that have been enacted and measures that are envisaged.

Given the uncertainty surrounding long-term projections, the assessment by the Commission and the Council should include stress tests that provide an indication of the risks to public finance sustainability in the event of adverse demographic, economic or budgetary developments.

In addition to the requirements mentioned above, Member States may present different projections, based on national calculations. In such a case, Member States should explain in detail the underlying assumptions of these projections, the used methodology, the policies implemented or planned to meet the assumptions, and the divergences between the national projections and the common projections produced by the Working Group on Ageing attached to the Economic Policy Committee.

These national projections and their assumptions, including their plausibility, will enter the basis for the assessment by the Commission and the Council of sustainability of the Member States' public finances within the context of the SGP.

Sensitivity analysis

Given the inevitability of forecast errors, Stability and Convergence Programmes include comprehensive sensitivity analyses and/or develop alternative scenarios, in order to enable the Commission and the Council to consider the complete range of possible fiscal outcomes.

In particular, the programmes shall provide an analysis of how changes in the main economic assumptions would affect the budgetary and debt position and indicate the underlying assumptions about how revenues and expenditures are projected to react to variations in economic variables. This should include the impact of different interest rate assumptions and, for non-participating Member States, of different exchange rate assumptions, on the budgetary and debt position. Countries that do not use the common external assumptions should endeavour to provide a sensitivity analysis also on main extra-EU variables when the differences are significant.

In the case of 'major structural reforms' (see section I), the programmes shall also provide an analysis of how changes in the assumptions would affect the effects on the budget and potential growth.

Time horizon

The information about paths for the general government surplus/ deficit ratio, the expenditure and revenue ratios and their components as well as for debt ratio and the main economic assumptions should be on an annual basis and should cover, as well as the current and preceding year, at least the three following years (Article 3(3) and Article 7(3)), leaving it open to Member States to cover a longer period if they so wish.

The horizon for the long-term projections on the budgetary implications of ageing should cover the same period as the EPC projections.

Updating of programmes

In order to ensure proper ex ante coordination and surveillance of economic policies, submissions of SCP updates should take place each year preferably by mid–April, but in any case not later than the end of April. The whole process should be completed with the adoption of Council Opinions on the programmes as a rule before the end of July each year.

Annual updates of Stability and Convergence Programmes should show how developments have compared with the budgetary targets in the previous programme or update, including the information on how the last year's Council Opinions on the Stability and Convergence Programmes and country-specific recommendations have been reflected in national budgets. When applicable, they should explain in detail the reasons for the deviations from the budgetary targets (with a special focus on developments in government expenditure). When substantial deviations occur, the update should mention whether measures are taken to rectify the situation, and provide information on these measures.

<u>ANNEX 1</u>

MODEL STRUCTURE FOR THE STABILITY AND CONVERGENCE PROGRAMMES

1. Overall policy framework and objectives

2. Economic outlook
(on the basis of Tables 1a-1d, 5 and 8)
- *World economy/technical assumptions*
- *Cyclical developments and current prospects*
- *Medium-term scenario*
- *Sectoral balances*
- *Growth implications of "major structural reforms"*

3. General government balance and debt
(on the basis of Tables 2, 3, 4 and 5)
- *Policy strategy*
- *Medium-term objectives*
- *Actual balances and updated budgetary plans for the current year*
- *Medium-term budgetary outlook, including description and quantification of fiscal strategy*
- *Structural balance (cyclical component of the deficit, one-off and temporary measures), fiscal stance*
- *Debt levels and developments, analysis of below-the-line operations and stock-flow adjustments*
- *Budgetary implications of "major structural reforms"*

4. Sensitivity analysis and comparison with previous update
(on the basis of Table 6)
- *Alternative scenarios and risks*
- *Sensitivity of budgetary projections to different scenarios and assumptions*
- *Comparison with previous update*

5. Sustainability of public finances
(on the basis of Table 7)
- *Policy strategy*
- *Long-term budgetary prospects, including the implications of ageing populations*

6. Quality of public finances
(on the basis of Tables 2 and 3)
- *Policy strategy*
- *Composition, efficiency and effectiveness of expenditure*
- *Structure and efficiency of revenue systems*

7. Institutional features of public finances
- *Implementation of national budgetary rules*
- *Budgetary procedures, incl. public finance statistical governance*
- *Other institutional developments in relation to public finances*

ANNEX 2

TABLES TO BE CONTAINED IN THE STABILITY AND CONVERGENCE PROGRAMMES AND THEIR UPDATES

Provision of data on variables in bold characters is a requirement.
Provision of data on other variables is optional but highly desirable.

Table 1a. Macroeconomic prospects

	ESA Code	**Year X-1** Level	**Year X-1** rate of change	**Year X** rate of change	**Year X+1** rate of change	**Year X+2** rate of change	**Year X+3** rate of change
1. Real GDP	B1*g						
2. Nominal GDP	B1*g						
Components of real GDP							
3. Private consumption expenditure	P.3						
4. Government consumption expenditure	P.3						
5. Gross fixed capital formation	P.51						
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53						
7. Exports of goods and services	P.6						
8. Imports of goods and services	P.7						
Contributions to real GDP growth							
9. Final domestic demand		-					
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-					
11. External balance of goods and services	B.11	-					

Table 1b. Price developments

	ESA Code	**Year X-1** Level	**Year X-1** rate of change	**Year X** rate of change	**Year X+1** rate of change	**Year X+2** rate of change	**Year X+3** rate of change
1. GDP deflator							
2. Private consumption deflator							
3. HICP[1]							
4. Public consumption deflator							
5. Investment deflator							
6. Export price deflator (goods and services)							
7. Import price deflator (goods and services)							

[1] Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	**Year X-1**	**Year X-1**	**Year X**	**Year X+1**	**Year X+2**	**Year X+3**
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons[1]							
2. Employment, hours worked[2]							
3. Unemployment rate (%)[3]							
4. Labour productivity, persons[4]							
5. Labour productivity, hours worked[5]							
6. Compensation of employees	D.1						
7. Compensation per employee					optional	optional	optional

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

[5]Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	**Year X-1**	**Year X**	**Year X+1**	**Year X+2**	**Year X+3**
1. Net lending/borrowing vis-à-vis the rest of the world	B.9					
of which: - Balance on goods and services - Balance of primary incomes and transfers - Capital account						
2. Net lending/borrowing of the private sector	B.9					
3. Net lending/borrowing of general government	EDP B.9					
4. Statistical discrepancy			optional	optional	optional	optional

Table 2. General government budgetary prospects

	ESA Code	**Year X-1**	**Year X-1**	**Year X**	**Year X+1**	**Year X+2**	**Year X+3**
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13						
2. Central government	S.1311						
3. State government	S.1312						
4. Local government	S.1313						
5. Social security funds	S.1314						
General government (S13)							
6. Total revenue	TR						
7. Total expenditure	TE[1]						
8. Net lending/borrowing	EDP B.9						
9. Interest expenditure	EDP D.41						
10. Primary balance[2]							
11. One-off and other temporary measures[3]							
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)							
12a. Taxes on production and imports	D.2					optional	optional
12b. Current taxes on income, wealth, etc	D.5					optional	optional
12c. Capital taxes	D.91					optional	optional
13. Social contributions	D.61					optional	optional
14. Property income	D.4					optional	optional
15. Other [4]						optional	optional
16=6. Total revenue	TR						
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]							
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2						
17a. Compensation of employees	D.1						
17b. Intermediate consumption	P.2						
18. Social payments (18=18a+18b)							
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131						
18b. Social transfers other than in kind	D.62						
19=9. Interest expenditure	EDP D.41						
20. Subsidies	D.3						
21. Gross fixed capital formation	P.51						
22. Other[6]							
23=7. Total expenditure	TE[1]						
p.m.: Government consumption (nominal)	P.3						

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	**Year X-2**	**Year X+3**
1. General public services	1		
2. Defence	2		
3. Public order and safety	3		
4. Economic affairs	4		
5. Environmental protection	5		
6. Housing and community amenities	6		
7. Health	7		
8. Recreation, culture and religion	8		
9. Education	9		
10. Social protection	10		
11. Total expenditure (=item 7=23 in Table 2)	TE[1]		

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	**Year X-1**	**Year X**	**Year X+1**	**Year X+2**	**Year X+3**
1. Gross debt[1]						
2. Change in gross debt ratio						
Contributions to changes in gross debt						
3. Primary balance[2]						
4. Interest expenditure[3]	EDP D.41					
5. Stock-flow adjustment						
of which: - Differences between cash and accruals[4] - Net accumulation of financial assets[5]						
of which: *- privatisation proceeds* - Valuation effects and other[6]						
p.m.: Implicit interest rate on debt[7]						
Other relevant variables						
6. Liquid financial assets[8]						
7. Net financial debt (7=1-6)						

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	**Year X-1**	**Year X**	**Year X+1**	**Year X+2**	**Year X+3**
1. Real GDP growth (%)						
2. Net lending of general government	EDP B.9					
3. Interest expenditure	EDP D.41					
4. One-off and other temporary measures[1]						
5. Potential GDP growth (%)						
contributions: - labour - capital - total factor productivity						
6. Output gap						
7. Cyclical budgetary component						
8. Cyclically-adjusted balance (2 - 7)						
9. Cyclically-adjusted primary balance (8 + 3)						
10. Structural balance (8 - 4)						

[1]A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	**Year X-1**	**Year X**	**Year X+1**	**Year X+2**	**Year X+3**
Real GDP growth (%)						
Previous update						
Current update						
Difference						
General government net lending (% of GDP)	EDP B.9					
Previous update						
Current update						
Difference						
General government gross debt (% of GDP)						
Previous update						
Current update						
Difference						

Table 7. Long-term sustainability of public finances

% of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditure							
Of which: age-related expenditures							
Pension expenditure							
Social security pension							
Old-age and early pensions							
Other pensions (disability, survivors)							
Occupational pensions (if in general government)							
Health care							
Long-term care *(this was earlier included in the health care)*							
Education expenditure							
Other age-related expenditures							
Interest expenditure							
Total revenue							
Of which: property income							
Of which: from pensions contributions (or social contributions if appropriate)							
Pension reserve fund assets							
Of which: consolidated public pension fund assets (assets other than government liabilities)							
Assumptions							
Labour productivity growth							
Real GDP growth							
Participation rate males (aged 20-64)							
Participation rates females (aged 20-64)							
Total participation rates (aged 20-64)							
Unemployment rate							
Population aged 65+ over total population							

Table 8. Basic assumptions

This table should preferably be included in the programme itself; if not, these assumptions should be transmitted to the Council and the Commission together with the programme.

	Year X-1	Year X	Year X+1	Year X+2	Year X+3
Short-term interest rate[1] (annual average)					
Long-term interest rate (annual average)					
USD/€ exchange rate (annual average) (euro area and ERM II countries)					
Nominal effective exchange rate					
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)					
World excluding EU, GDP growth					
EU GDP growth					
Growth of relevant foreign markets					
World import volumes, excluding EU					
Oil prices (Brent, USD/barrel)					

[1]If necessary, purely technical assumptions.