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2010/0276 (CNS)

Proposal for a

COUNCIL REGULATION (EU) No …/…

amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

The global economic and financial crisis has exposed and amplified the need for greater co-ordination and enhanced surveillance of economic policies in the economic and monetary union (EMU). Existing instruments and methods of co-ordination and surveillance enabled the EU to weather a storm that no Member State could have withstood on its own. The European institutions and Member States reacted quickly and are continuing to work together to recover from a crisis that has no precedent in our generation.

However, these recent experiences also revealed remaining gaps and weaknesses in the current system of coordination and in the existing surveillance procedures. There is a broad agreement that the framework for EMU should be urgently strengthened in order to anchor macroeconomic stability and the sustainability of public finances, which are preconditions for durable output and employment growth.

The crisis has drastically reversed the favourable economic and financial conditions that prevailed until 2007 and made clear yet again that windfalls accumulated during good times had not been sufficiently used to create room for manoeuvre when times turn bad. Very sizeable consolidation will be necessary in most Member States to bring public debt back onto a downward path. This is all the more urgent as European societies and economies are facing the effects of ageing populations, which will put further pressure on labour supply and public budgets. Reducing debt levels is highly relevant for most countries in view of their negative effects on economic incentives and growth through higher taxes and risk premia.

The key instrument for fiscal policy co-ordination and surveillance is the Stability and Growth Pact (SGP), which implements the Treaty provisions on budgetary discipline. Strengthening the Pact is important for both increasing the credibility of the agreed co-ordinated fiscal exit strategy and avoiding a repetition of past mistakes. The set of proposals now being presented aims to strengthen the Pact by: (i) improving its provisions in the light of experience, not least of the crisis; (ii) equipping it with more effective enforcement instruments; and (iii) complementing it with provisions on national fiscal frameworks. This set of proposals is part of a broader reform of economic governance under the umbrella of the Europe 2020 strategy, which includes proposals for addressing macroeconomic imbalances through stronger surveillance, including alert and sanction mechanisms. The different strands of economic policy coordination, including surveillance of structural reforms, are to be integrated in a new surveillance cycle, the European Semester, which will bring together existing processes under the SGP and the Broad Economic Policy Guidelines, including simultaneous submission of stability and convergence programmes and national reform programmes.

2. RESULTS OF CONSULTATIONS WITH INTERESTED PARTIES

The outlines of the present proposals were announced by the Commission in two communications: Reinforcing economic policy coordination of 12 May 2010 and Enhancing economic policy coordination for stability, growth and jobs – Tools for stronger EU economic governance of 30 June 2010. In opting for a formal communication, the Commission wished to demonstrate its commitment to fostering dialogue with Member States, the European

Parliament and all stakeholders, while at the same time delivering concrete proposals for action.

In June 2010, the European Council agreed on the urgent need to reinforce the coordination of our economic policies. The agreement included first orientations as regards the SGP and budgetary surveillance. In particular, the European Council agreed on: (i) strengthening both the preventive and corrective parts of the SGP, including with sanctions and taking due account of the particular situation of euro-area Member States; (ii) giving, in budgetary surveillance, a much more prominent role to levels and evolutions of debt and overall sustainability; (iii) ensuring that all Member States have national budgetary rules and medium term budgetary frameworks in line with the SGP; (iv) ensuring the quality of statistical data.

The European Council invited the Task Force on economic governance chaired by its President and established in March 2010 and the Commission to rapidly develop further and make operational these orientations. A constructive relationship developed between the Commission and the Task Force. The Commission contributed to the work of the Task Force through the Communications referred to above and through ad hoc contributions.

3. LEGAL ELEMENTS OF THE PROPOSAL

The legal basis for the SGP is laid down in Articles 121 and 126 of the Treaty on the Functioning of the European Union. The SGP consists 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 (referred to as preventive part); Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure (referred to as corrective part); and the Resolution of the European Council of 17 June 1997 on the Stability and Growth Pact. These Regulations were amended in 2005 by Regulations (EC) No 1055/2005 and (EC) No 1056/2005 and complemented by the Council Report of 20 March 2005 on 'Improving the implementation of the Stability and Growth Pact'. The present proposals seek further amendments to Regulations No 1466/97 and (EC) No 1467/97. Additional enforcement instruments are proposed in a new Regulation of the European Parliament and the Council on the effective enforcement of budgetary surveillance in the euro area, based on Article 136 of the Treaty, in combination with Article 121(6). The requirements for the budgetary frameworks of the Member States are the subject of a new Council Directive based on Article 126(14): the Directive aims in particular to specify the obligations of national authorities to comply with the provisions of Article 3 of Protocol No 12 to the Treaties on the excessive deficit procedure.

The preventive part of the SGP is meant to ensure that Member States follow prudent fiscal policies so that there is no need to adopt more stringent forms of coordination to avoid public finance sustainability being put at risk, with potential negative consequences for EMU as a whole. Accordingly, Member States are required to present stability and convergence programmes outlining their plans to achieve medium-term budgetary objectives (MTOs), which are defined as a percentage of GDP in structural terms (i.e. adjusting for the effect of the cycle and excluding one-off and temporary measures) and are differentiated across countries around a close-to-balance position to reflect the level of public debt and liabilities related to ageing. Member States not having reached their MTO are expected to converge towards it at an annual pace of 0.5% of GDP in structural terms.

However, progress towards MTOs has been generally insufficient, leaving public finances badly exposed to the economic downturn. Moreover, the structural balance has in practice proved an insufficient measure of a country's underlying fiscal position, owing to the difficulty of assessing the cyclical position of the economy in real time and to insufficient account being taken of revenue windfalls and shortfalls not directly related to the economic cycle (in particular housing and financial market developments). As a result, in a number of countries, even apparently sound budgetary positions before the crisis masked a strong reliance on windfall revenues to finance expenditure, the reversal of which contributed to soaring budget deficits.

To respond to these shortcomings the reform of the preventive part that is being proposed, while retaining the current MTOs and the 0.5% of GDP annual convergence requirement, makes them operational in terms of a new principle of prudent fiscal policy-making. This principle implies that annual expenditure growth should not exceed – and if the MTO has not been achieved should be clearly below – a prudent medium-term rate of growth of GDP, unless the MTO has been significantly overachieved or the excess of expenditure growth over the prudent medium-term rate is matched by discretionary measures on the revenue side. The essential aim is to ensure that revenue windfalls are not spent but are instead allocated to debt reduction. The new principle will provide the benchmark against which countries' fiscal plans in the stability and convergence programme will be examined. Additionally, failure to respect keep to the agreed rate of growth of expenditure, in conjunction with the stipulated revenue measures, will make the Member State concerned liable to a warning from the Commission and, if persistent and/or particularly serious, a Council recommendation to take corrective action issued under Article 121 of the Treaty. Such a recommendation, while being issued in the context of the preventive part, would be backed, for the first time and for euro-area countries only, by an enforcement mechanism under Article 136 of the Treaty, in the form of an interest-bearing deposit, amounting to 0.2% of GDP. A procedure of 'reverse voting' mechanism is introduced for imposing the interest-bearing deposit: on the issue of a recommendation, the deposit would become due on proposal by the Commission, unless the Council decides to the contrary by qualified majority within ten days. The Council could reduce the amount of the deposit only unanimously or based on a Commission proposal and a reasoned request from the Member State concerned. The deposit will be returned with the accrued interest once the Council is satisfied that the situation giving rise to it has come to an end.

The corrective part of the SGP is meant to avoid gross errors in budgetary policies, which might put at risk the sustainability of public finances and potentially endanger EMU. This translates into the obligation for Member States to avoid excessive government deficits, which are defined against a numerical threshold for deficit (3% of GDP) and debt (60% of GDP or sufficiently declining toward it). The excessive deficit procedure (EDP) that implements the ban on excessive deficits provides for a sequence of steps, which, for euro-area countries, include the eventual imposition of financial sanctions.

The EDP has been regularly applied in line with the relevant provisions, even against the background of the exceptional circumstances of the financial crisis, thereby contributing to anchoring expectations of its orderly resolution. However a number of shortcomings have emerged. While the deficit and the debt criterion are in principle on an equal footing, and persistently high levels of debt arguably represent a more serious threat to public finance sustainability than occasionally high deficits, in practice the '3% of GDP' threshold has been the almost exclusive focus of the EDP, with debt playing a marginal role so far. This owes to the less straightforward nature of the debt threshold compared to the deficit, including the ambiguity of the notion of sufficiently diminishing pace of reduction and the greater impact on the debt ratio of variables outside the control of the government, notably inflation. The EDP is backed in principle by a strong enforcement mechanism, as financial sanctions can, and should be, imposed in the event of persistent failure to correct an excessive deficit. However, such sanctions arguably come into play too late in the process to represent an effective deterrent against gross fiscal policy errors, not least because the financial situation of the country concerned may have deteriorated so much as to make the threat of a fine less credible at the very time when it should become real. Finally, the recent crisis has highlighted that if the obligation to correct excessive deficits contributes to anchoring the expectation that government solvency will be maintained, the timeline of the correction and the profile of the adjustment may have to reflect EMU-wide considerations.

To respond to these shortcomings the following key proposals for the reform of the corrective part are being put forward.

The debt criterion of the EDP is to be made operational, notably through the adoption of a numerical benchmark to gauge whether the debt ratio is sufficiently diminishing toward the 60% of GDP threshold. Specifically, a debt-to-GDP ratio above 60% is to be considered sufficiently diminishing if its distance with respect to the 60% of GDP reference value has reduced over the previous three years at a rate of the order of one-twentieth per year. Non-compliance with this numerical benchmark is not, however, necessarily expected to result in the country concerned being placed in excessive deficit, as this decision would need to take into account all the factors that are relevant, in particular for the assessment of debt developments, such as whether very low nominal growth is hampering debt reduction, together with risk factors linked to the debt structure, private sector indebtedness and implicit liabilities related to ageing. In line with the greater emphasis on debt, more consideration should be given to relevant factors in the event of non-compliance with the deficit criterion, if a country has a debt below the 60% of GDP threshold.

The more flexible approach put forward with respect to considering the relevant factors in the steps of determining the existence of an excessive deficit could also benefit countries undertaking systemic pension reforms, beyond the currently foreseen five-year transitory period. The special provisions of the SGP for systemic pension reforms with regards the deficit criterion are also extended to the debt criterion; through establishing the same five-year transitory period for considering the net costs of such reforms when assessing the compliance with the debt criterion. Finally, equal consideration shall be given to the partial or total reversal of previously implemented systemic pension reforms, during both the launch and the abrogation of an EDP.

Enforcement is strengthened by introducing a new set of financial sanctions for euro-area Member States, which would apply much earlier in the process according to a graduated approach. Specifically, a non-interest-bearing deposit amounting to 0.2% of GDP would apply upon a decision to place a country in excessive deficit, which would be converted into a fine in the event of non-compliance with the initial recommendation to correct the deficit. The amount is equal to the fixed component of the sanctions already provided for in the final step of the EDP. It also bears a link with the EU budget, which should facilitate the envisaged move to a system of enforcement based on the EU budget as outlined in the above-mentioned Commission Communication of 30 June 2010. Further non-compliance would result in the sanction being stepped up, in line with the already existing provisions in the SGP. To reduce discretion in enforcement, the 'reverse voting' mechanism is envisaged for imposing the new sanctions in connection with the successive steps of the EDP. Specifically, at each step of the

EDP, the Commission will make a proposal for the relevant sanction, and this will be considered adopted, unless the Council decides to the contrary by qualified majority within ten days. The size of the non-interest-bearing deposit or the fine could only be reduced or cancelled by the Council unanimously or based on a specific proposal from the Commission on grounds of exceptional economic circumstances or following a reasoned request by the Member State concerned.

Moreover, the criteria for assessing compliance with the recommendations at each step, including the possibility of allowing an extension of the deadlines for the correcting the excessive deficit, are clarified by placing explicit emphasis on the fiscal variables that can be assumed to be under the direct control of the government, in particular expenditure, by analogy with the approach proposed for the preventive part. Beyond these country-specific circumstances, the possibility is introduced of extending the deadlines also in the event of a general economic crisis.

Effective enforcement of the EMU budgetary coordination framework cannot be expected to derive only from provisions laid down at EU level. The particular decentralised nature of fiscal policy-making in the EU and the general need for national ownership of EU rules make it essential that the objectives of the EMU budgetary coordination framework are reflected in the national budgetary frameworks. A national budgetary framework is the set of elements that form the basis of national fiscal governance, i.e. the country-specific institutional policy setting that shapes fiscal policy-making at national level. This includes public accounting systems, statistics, forecasting practices, numerical fiscal rules, budgetary procedures governing all stages of the budget process and medium term budgetary frameworks in particular, and fiscal relations across government sub-sectors. While Member States' specific needs and preferences must be respected, a number of features stand out as being needed in terms of ensuring minimum quality and consistency with the EMU budgetary framework. These are the subject of the Directive on national budgetary frameworks that is being proposed to complement the reform of the SGP. Such features firstly require that the most primary elements of national budgetary frameworks, namely accounting and statistical issues and forecasting practices, work in line with minimum European standards to facilitate transparency and the monitoring of fiscal developments. Domestic budgetary frameworks need also to adopt a multi-annual fiscal planning perspective so as to ensure the achievement of the medium-term objectives set at EU level. Additionally, Member States must have in place numerical fiscal rules conducive to compliance with the deficit and debt thresholds. Member States must ensure that these features apply to all general government sub-sectors. National authorities must also guarantee the transparency of the budget process by providing detailed information on existing extra-budgetary funds, tax expenditures and contingent liabilities.

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amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the second subparagraph of Article 126(14) thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national Parliaments,

Having regard to the opinion of the European Parliament[1],

Having regard to the opinion of the European Central Bank (ECB),

Acting in accordance with a special legislative procedure,

Whereas:

(1) The coordination of the economic policies of the Member States within the Union, as provided by the Treaty, should entail compliance with the guiding principles of stable prices, sound public finances and monetary conditions and a sustainable balance of payments.

(2) The Stability and Growth Pact 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[2], Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[3] and the Resolution of the European Council of 17 June 1997 on the Stability and Growth Pact[4]. Regulations (EC) No 1466/97 and (EC) No 1467/97 were amended in 2005 by Regulations (EC) No 1055/2005 and (EC) No 1056/2005 respectively. In addition, the Council Report of 20 March 2005 on 'Improving the implementation of the Stability and Growth Pact' was adopted.

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1 OJ C , , p. .
2 OJ L 209, 2.8.1997, p. 1.
3 OJ L 209, 2.8.1997, p. 6.
4 OJ C 236, 2.8.1997, p. 1.

(3) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth underpinned by financial stability and conducive to employment creation.

(4) The common framework for economic governance requires to be enhanced, including with regard to budgetary surveillance, in line with the high degree of integration achieved by Member States economies within the European Union, and particularly in the euro area.

(5) The rules on budgetary discipline should be strengthened in particular by giving a more prominent role to the level and evolution of debt and overall sustainability.

(6) Implementing the existing excessive deficit procedure on the basis of both the deficit criterion and the debt criterion requires defining a numerical benchmark against which to assess whether the ratio of government debt to gross domestic product is sufficiently diminishing and approaching the reference value at a satisfactory pace.

(7) The establishment of the existence of an excessive deficit based on the debt criterion and the steps leading to it should not be based solely on non-compliance with the numerical benchmark, but always take into account the whole range of relevant factors covered by the Commission report under Article 126(3) of the Treaty.

(8) In the establishment of the existence of an excessive deficit based on the deficit criterion and the steps leading to it there is a need to take into account the whole range of relevant factors covered by the report under Article 126(3) of the Treaty if the government debt to gross domestic product does not exceed the reference value.

(9) The Commission report under Article 126(3) of the Treaty should appropriately consider the quality of the national fiscal framework, as it plays a crucial role in supporting fiscal consolidation and sustainable public finances.

(10) In order to support the monitoring of compliance with Council recommendations and notices for the correction of the situations of excessive deficit, there is a need that these specify annual budgetary targets consistent with the required fiscal improvement in cyclically adjusted terms, net of one-off and temporary measures.

(11) The assessment of effective action will benefit from taking compliance with general government expenditure targets as a reference in conjunction with the implementation of planned specific revenue measures.

(12) In assessing the case for an extension of the deadline for correcting the excessive deficit, special consideration should be given to severe economic downturns of a general nature.

(13) It is appropriate to step up the application of the financial sanctions envisaged by Article 126(11) of the Treaty so that they constitute a real incentive for compliance with the notices under Article 126(9).

(14) In order to ensure compliance with the fiscal surveillance framework of the Union for participating Member States, rules-based sanctions should be designed on the basis of Article 136 of the Treaty, ensuring fair, timely and effective mechanisms for compliance with the Stability and Growth pact rules.

(15) References contained in Regulation (EC) No 1467/97 should take account of the new Article numbering of the Treaty on the Functioning of the European Union and to the replacement of Council Regulation (EC) No 3625/93 by Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community[5].

(16) Regulation (EC) No 1467/97 should therefore be amended accordingly,

HAS ADOPTED THIS REGULATION:

Article 1

Regulation (EC) No 1467/97 is amended as follows:

1. Article 1 is replaced by the following:

'*Article 1*

1. This Regulation sets out the provisions to speed up and clarify the excessive deficit procedure, having as its objective to deter excessive government deficits and, if they occur, to further prompt their correction, where compliance with the budgetary discipline is examined on the basis of the government deficit and government debt criteria.

2. For the purpose of this Regulation 'participating Member States' shall mean those Member States whose currency is the euro.'

2. Article 2 is amended as follows:

(a) in paragraph 1, the first subparagraph is replaced by the following:

'1. The excess of a government deficit over the reference value shall be considered exceptional, in accordance with the second indent of Article 126 (2) (a) of the Treaty, when resulting from an unusual event outside the control of the Member State concerned and which has a major impact on the financial position of general government, or when resulting from a severe economic downturn.'

(b) the following paragraph 1a is inserted:

'1a. When it exceeds the reference value, the ratio of the government debt to gross domestic product (GDP) is to be considered sufficiently diminishing and approaching the reference value at a satisfactory pace in accordance with Article 126 (2) (b) of the Treaty if the differential with respect to the reference value has reduced over the previous three years at a rate of the order of one-twentieth per year. For a period of 3 years from [date of entering into force of this Regulation - to be inserted], account shall be taken of the backward-looking nature of this indicator in its application.'

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5 OJ L 145, 10.6.2009 p. 1.

(c) paragraph 3 is replaced by the following:

'3. The Commission, when preparing a report under Article 126(3) of the Treaty shall take into account all relevant factors as indicated in that Article. The report shall appropriately reflect developments in the medium-term economic position (in particular potential growth, prevailing cyclical conditions, inflation, excessive macroeconomic imbalances) and developments in the medium-term budgetary position (in particular, fiscal consolidation efforts in ‘good times’, public investment, the implementation of policies in the context of the common growth strategy for the Union and the overall quality of public finances, in particular, compliance with Council Directive […] on requirements for budgetary frameworks of the Member States). The report shall also analyse developments in the medium-term debt position as relevant (in particular, it appropriately reflects risk factors including the maturity structure and currency denomination of the debt, stock-flow operations, accumulated reserves and other government assets; guarantees, notably linked to the financial sector; liabilities both explicit and implicit related to ageing and private debt to the extent that it may represent a contingent implicit liability for the government). Furthermore, the Commission shall give due consideration 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 and which the Member State has put forward to the Commission and to the Council. In that context, special consideration shall be given to financial contributions to fostering international solidarity and to achieving Union policy goals, including financial stability.'

(d) paragraph 4 is replaced by the following:

'4. The Commission and the Council shall make a balanced overall assessment of all the relevant factors, specifically, the extent to which they affect the assessment of compliance with the deficit and/or the debt criteria as aggravating or mitigating factors. When assessing compliance on the basis of the deficit criterion, if the ratio of the government debt to GDP exceeds the reference value, these factors shall be taken into account in the steps leading to the decision on the existence of an excessive deficit provided for in paragraphs 4, 5 and 6 of Article 126 of the Treaty only if the double condition of the overarching principle — that, before these relevant factors 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.'

(e) paragraph 7 is replaced by the following:

'7. In the case of Member States where the excess of the deficit or the breach of the requirements of the debt criterion according to Article 126 (2) (b) of the Treaty reflects the implementation of a pension reform introducing a multi-pillar system that includes a mandatory, 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 and debt figures. In cases where the debt ratio exceeds the reference value, the cost of the reform shall be considered only if the deficit remains close to the reference value. For that purpose, for a period of five years starting from the date of entry into force of such a reform, consideration shall be given to its net cost as reflected in deficit and debt developments on the basis of a linear degressive scale. Additionally, irrespective of the date of entry into force of the reform, its net cost as reflected in debt developments shall be given consideration for a transitional period of five years from [date of entry into force of this Regulation, to be inserted] on the basis of the same linear degressive scale. The net cost as thus calculated shall be taken into account also for the decision of the Council under Article 126(12) of the Treaty on the abrogation of some or all of its decisions under paragraphs 6 to 9 and 11 of Article 126 of the Treaty, if the deficit has declined substantially and continuously and has reached a level that comes close to the reference value and, in case of non-fulfilment of the requirements of the debt criterion, the debt has been put on a declining path. Moreover, equal consideration shall be given to the reduction in this net cost resulting from the partial or total reversal of an above mentioned pension reform.'

3. Article 3 is amended as follows:

(a) paragraph 2 is replaced by the following:

'2. Taking fully into account the opinion referred to in paragraph 1, the Commission, if it considers that an excessive deficit exists, shall address an opinion and a proposal to the Council in accordance with Article 126(5) and (6) of the Treaty.'

(b) In paragraph 3, the reference to 'Article 4(2) and (3) of Regulation (EC) No 3605/93' is replaced by the reference to 'Article 3(2) and (3) of Regulation (EC) No 479/2009'.

(c) paragraph 4 is replaced by the following:

'4. The Council recommendation made in accordance with Article 126(7) of the Treaty shall establish a deadline of six months at most for effective action to be taken by the Member State concerned. The Council recommendation shall also establish a deadline for the correction of the excessive deficit, which should be completed in the year following its identification unless there are special circumstances. In the recommendation, the Council shall request that the Member State achieves annual budgetary targets which, on the basis of the forecast underpinning the recommendation, are consistent with a minimum annual improvement of at least 0,5 % of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation.'

(d) the following paragraph 4a is inserted:

'4a. Within the deadline of six month at most provided for in paragraph 4, the Member State concerned shall report to the Commission and the Council on action taken in response to the Council recommendation under Article 126(7) of the Treaty. The report shall include the targets for the government expenditure and for the discretionary measures on the revenue side consistent with the Council recommendation under Article 126(7) of the Treaty, as well as information on the measures taken and the nature of those envisaged to achieve the targets. The report shall be made public.'

(e) paragraph 5 is replaced by the following:

'5. If effective action has been taken in compliance with a recommendation under Article 126(7) of the Treaty and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that recommendation, the Council may decide, on a recommendation from the Commission, to adopt a revised recommendation under Article 126(7) of the Treaty. The revised recommendation, taking into account the relevant factors mentioned in Article 2(3) of this Regulation, may notably extend the deadline for the correction of the excessive deficit by one year as a rule. The Council shall assess the existence of unexpected adverse economic events with major unfavourable consequences for government finances against the economic forecasts in its recommendation. The Council may also decide, on a recommendation from the Commission, to adopt a revised recommendation under Article 126(7) of the Treaty in case of a severe economic downturn of a general nature.'

4. in Article 4, paragraph 2 is replaced by the following:

'2. The Council, when considering whether effective action has been taken in response to its recommendations made in accordance with Article 126(7) of the Treaty, shall base its decision on the report submitted by the Member State concerned in accordance with Article 3(4a) of this Regulation and its implementation as well as on any other publicly announced decisions by the Government of the Member State concerned.'

5. Article 5 is amended as follows:

(a) paragraph 1 is replaced by the following:

'1. Any Council decision to give notice to the participating Member State concerned to take measures for the deficit reduction in accordance with Article 126(9) of the Treaty shall be taken within two months of the Council decision establishing that no effective action has been taken in accordance with Article 126(8). In the notice, the Council shall request that the Member State achieve annual budgetary targets which, on the basis of the forecast underpinning the notice, are consistent with a minimum annual improvement of at least 0,5 % of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the notice. The Council shall also indicate measures conducive to the achievement of these targets.'

(b) the following paragraph 1a is inserted:

'1a. Following the Council notice given in accordance with Article 126(9) of the Treaty, the Member State concerned shall report to the Commission and the Council on action taken in response to the Council notice. The report shall include the targets for the government expenditure and for the discretionary measures on the revenue side as well as information on the actions being taken in response to the specific Council recommendations so as to allow the Council to take, if necessary, the decision in accordance with Article 6 (2) of this Regulation. The report shall be made public.'

(c) paragraph 2 is replaced by the following:

'2. If effective action has been taken in compliance with a notice under Article 126(9) of the Treaty and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that notice, the Council may decide, on a recommendation from the Commission, to adopt a revised notice under Article 126(9) of the Treaty. The revised notice, taking into account the relevant factors mentioned in Article 2(3) of this Regulation, may notably extend the deadline for the correction of the excessive deficit by one year as a rule. The Council shall assess the existence of unexpected adverse economic events with major unfavourable consequences for government finances against the economic forecasts in its notice. The Council may also decide, on a recommendation from the Commission, to adopt a revised notice under Article 126(9) of the Treaty in case of a severe economic downturn of a general nature.'

6. Article 6 is replaced by the following:

'Article 6

1. The Council, when considering whether effective action has been taken in response to its notice made in accordance with Article 126(9) of the Treaty, shall base its decision on the report submitted by the Member State concerned in accordance to Article 5(1a) of this Regulation and its implementation as well as on any other publicly announced decisions by the Government of the Member State concerned.

2. Where the conditions to apply Article 126(11) of the Treaty are met, the Council shall impose sanctions in accordance with Article 126 (11). Any such decision shall be taken no later than four months after the Council decision giving notice to the participating Member State concerned to take measures in accordance with Article 126 (9).'

7. in Article 7, the reference to 'Article 4(2) and (3) of Regulation (EC) No 3605/93' is replaced by the reference to 'Article 3(2) and (3) of Regulation (EC) No 479/2009'.

8. Article 8 is replaced by the following:

'*Article 8*

Any Council decision to intensify sanctions, in accordance with Article 126(11) of the Treaty, shall be taken no later than two months after the reporting dates pursuant to Regulation (EC) No 479/2009. Any Council decision to abrogate some or all of its decisions in accordance with Article 126(12) of the Treaty shall be taken as soon as possible and in any case no later than two months after the reporting dates pursuant to Regulation (EC) No 479/2009.'

9. in the third paragraph of Article 9, the reference to 'Article 6' is replaced by the reference to 'Article 6(2)'.

10. Article 10 is amended as follows:

(a) the introductory phrase of paragraph 1 is replaced by the following:

'1. The Commission and the Council shall regularly monitor the implementation of action taken:'

(b) in paragraph 3, the reference to 'Regulation (EC) No 3605/93' is replaced by a reference to 'Regulation (EC) No 479/2009'.

11. Article 11 is replaced by the following:

'*Article 11*

Whenever the Council decides to apply sanctions to a participating Member State in accordance with Article 126(11) of the Treaty, a fine shall, as a rule, be required. The Council may decide to supplement this fine by the other measures provided for in Article 126(11) of the Treaty.'

12. Article 12 replaced by the following:

'*Article 12*

1. The amount of the fine shall comprise a fixed component equal to 0,2 % of GDP, and a variable component. The variable component shall amount to one tenth of the difference between the deficit as a percentage of GDP in the preceding year and either the reference value for government deficit or, if non compliance with budgetary discipline includes the debt criterion, the general government balance as a percentage of GDP that should have been achieved in the same year according to the notice issued under Article 126(9) of the Treaty.

2. Each following year, until the decision on the existence of an excessive deficit is abrogated, the Council shall assess whether the participating Member State concerned has taken effective action in response to the Council notice in accordance with Article 126(9) of the Treaty. In this annual assessment the Council shall decide, in accordance with Article 126(11) of the Treaty, to intensify the sanctions, unless the participating Member State concerned has complied with the Council notice. If

an additional fine is decided, it shall be calculated in the same way as for the variable component of the fine in paragraph 1.

3. Any single fine referred to in paragraphs 1 and 2 shall not exceed the upper limit of 0,5 % of GDP.'

13. Article 13 is repealed and the reference to it in Article 15 is replaced by a reference to 'Article 12'.

14. Article 16 is replaced by the following:

'Article 16

Fines referred to in Article 12 of this Regulation shall constitute other revenue referred to in Article 311 of the Treaty and shall be distributed among participating Member States which do not have excessive deficit as determined in accordance with Article 126(6) of the Treaty and which are not the subject of an excessive imbalance procedure within the meaning of Regulation (EU) No […/…], in proportion to their share in the total gross national income (GNI) of the eligible Member States.'

15. All references to 'Article 104' are replaced throughout the Regulation by references to 'Article 126 of the Treaty'.

16. In point 2 of the Annex, the references in Column I to ' Article 4 (2) and (3) of Council Regulation (EC) No 3605/93' are replaced by references to 'Article 3(2) and (3) of Council Regulation (EC) No 479/2009'.

Article 2

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at,

For the Council
The President