EUROPEAN COMMISSION

Brussels, 24.11.2011
COM(2011) 829 final

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

providing supplementary information to the Commission Report on the exception clause of 13 July 2011

1. INTRODUCTION

Article 10 of Annex XI to the Council Regulation laying down the Staff Regulations for EU officials is an exception clause which is subject to legal conditions. In order to make use of the clause – which would lead to a legislative procedure based on Article 336 TFEU -, it must be analysed if these legal conditions are met or not. In case the conditions are not met, the use of the clause can be contested in Court by all individuals and institutions concerned or simply possibly affected which can lead in case of successful litigation to an additional obligation for the EU budget to pay interest for the late payment in places of employment where the salary or pension adjustment is positive.

It is important to underline that the fact that the conditions for using Article 10 (in combination with Article 336 TFEU) are not met, still allows using Article 336 TFEU directly in order to modify the Staff Regulations if this is considered to be politically appropriate.

As explained in the Report on the exception clause submitted in July 2011, the exception clause sets the following conditions that have jointly to be met before any action is taken:

– the deterioration has to be both serious and sudden,

– it must affect the economic and social situation at Union level,

– it must be assessed in the light of objective data provided by the Commission;

– and the deterioration has to be such that the method would not be able to take it properly into account due to its exceptional nature in terms of timing and magnitude. Indeed, the Court found that, firstly, the exception clause can be applied only "***in an extraordinary situation***" (paragraph 74 of the Court of Justice judgment in Case C-40/10) and, *secondly, it "enables account to be taken of the consequences of a deterioration in the economic and social situation which is both serious and sudden where, under the 'normal method'****, the remuneration of officials would not be adjusted quickly enough***" (paragraph 75).

In the framework of the 2010 annual adjustment the Council requested the Commission to submit, on the basis of the exception clause, appropriate proposals in order for the European Parliament and the Council to adopt them before the end of 2011. The draft Commission report on the exception clause was informally presented to the Council working group on 30 June 2011 and the Report was formally adopted by the Commission on 13 July 2011, in line with the time frame set by the Council.

The Commission Report on the exception clause of 13 July 2011 used a large number of economic and social indicators to assess whether it is necessary to use the exception clause in 2011 and was based on the Spring European Economic Forecasts released by DG ECFIN on 13 May 2011. This Report concluded that there had been no serious and sudden deterioration in the economic and social situation within the Union during the reference period of 1 July 2010 to mid-May 2011.

In order to address the request of the Council of 4 November 2011, the present document takes into account the latest developments in the European Union since the Spring European Economic Forecast until now.

The Forecast released by DG ECFIN on 10 November 2011 shows less optimistic trends for 2011 than the Spring Forecast as regards both economic and social indicators. The recovery has come to a standstill and the outlook for the European economy has worsened. Deteriorating confidence and intensified financial turmoil are affecting investment and consumption, while urgent fiscal consolidation is weighing on domestic demand and weakening global economic conditions are holding back exports. The recovery in the past two years has entailed only slow employment growth.

However, despite the short-term indicators pointing to an ongoing slowdown of economic activity in the EU, the overall growth performance for the current year is still relatively strong owing to a good start in the first quarter and the GDP growth is expected at 1.6%.

Although a strong slowdown is expected, the economic and social conditions cannot be qualified as extraordinary with regard to the method, which would justify applying measures going beyond the method. Indeed, the gloomy picture has also affected salaries in the public sector of the Member States, in particular due to the need of financial consolidation in the Member States, and modest salary increases for public sector workers are expected compared to the increases in compensation of employees in total economy this year (3%). The loss of purchasing power of national officials in central government until July 2011 through the application of the method equally applies to EU officials and will result in a 1.8 % cut of real salaries in all places of employment of EU civil servants. The worsening economic outlook has not resulted in circumstances under which the ‘normal method’ could not function and could not reflect the decisions taken by Member states for national officials.

The economic growth in the EU is expected to come to a standstill in the last quarter of 2011 and very modest economic growth is expected in 2012. If the economic situation continues deteriorating further and triggers actions by the Member States at national level which could not be covered fast enough by the normal application of the method, the Commission, in accordance with the principle of loyal cooperation as underlined by the Court of Justice, will propose to use the exception clause to take due account of the measures at national level and also to reduce the time lag between these measures coming into force and the next annual adjustment in one year.

The Commission would like to recall that the austerity measures and reforms that are recommended, planned or implemented in the Member States are reflected in its draft proposal for a Review of the Staff Regulations which is based directly on Article 336 TFEU and which would generate considerable savings of more than one billion Euros during the next Multiannual Financial Framework and over one billion a year in a long term perspective.

2. 2011 AUTUMN EUROPEAN ECONOMIC FORECAST

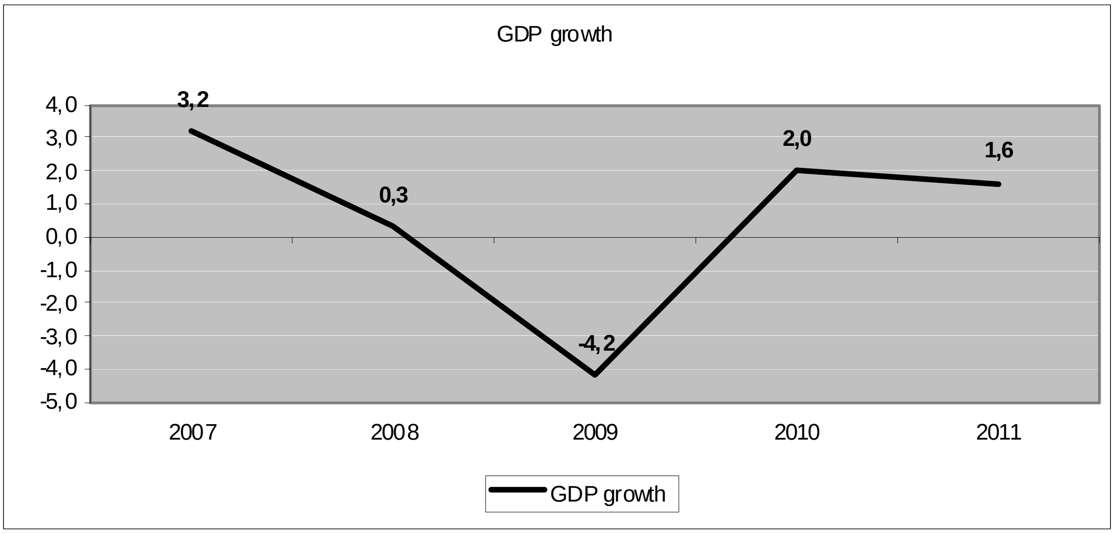
2.1. EU has experienced economic growth in 2010 and 2011

The recession ended in autumn 2009 and set the scene for a recovery in 2010. Overall, GDP increased by 2.0% in the EU and by 1.9% in the Euro area for the whole of 2010.[1]

The 2011 Autumn European Economic Forecast shows that short-term indicators are pointing to an ongoing slowing of economic activity in the EU, the Forecast also confirms, however, that EU economy will continue to grow in 2011 owing to a good start in the first quarter. As the Spring Forecast for 2011 (1.6% growth in euro area and 1.8% in EU) were revised downwards, the economic growth in Europe is expected to continue in 2011 along a trend of around 1.5% (euro area) and 1.6% (EU) in 2011. In the last quarter of 2011, the GDP growth is forecasted to be at a standstill while economic growth will only gain some modest traction in late 2012.

The slowdown in the economic recovery in 2011 is however not comparable to the turmoil that affected the Union in 2008 and 2009, when the economic growth decreased from 3.2% in 2007 to 0.3% in 2008 and then quickly moved into the largely negative zone, i.e. -4.2% in 2009.

Figure 1: GDP growth and decomposition within the EU-27 (annual % change)



Source: Eurostat (2007-2010) and DG ECFIN (2011)

2.2. Labour-market situation remains stable in 2010 and in 2011

The 2011 Autumn European Economic Forecast pointed out that headcount employment started to rise slowly in late 2010, as soon as the growth of hours worked began to level off. The delayed response of employment to the recovery was the counterpart to labour hoarding during the recession and entailed a considerable rebound in labour productivity. Despite the pick-up in economic growth in the EU, job creation has been weak and insufficient to bring about a significant reduction in

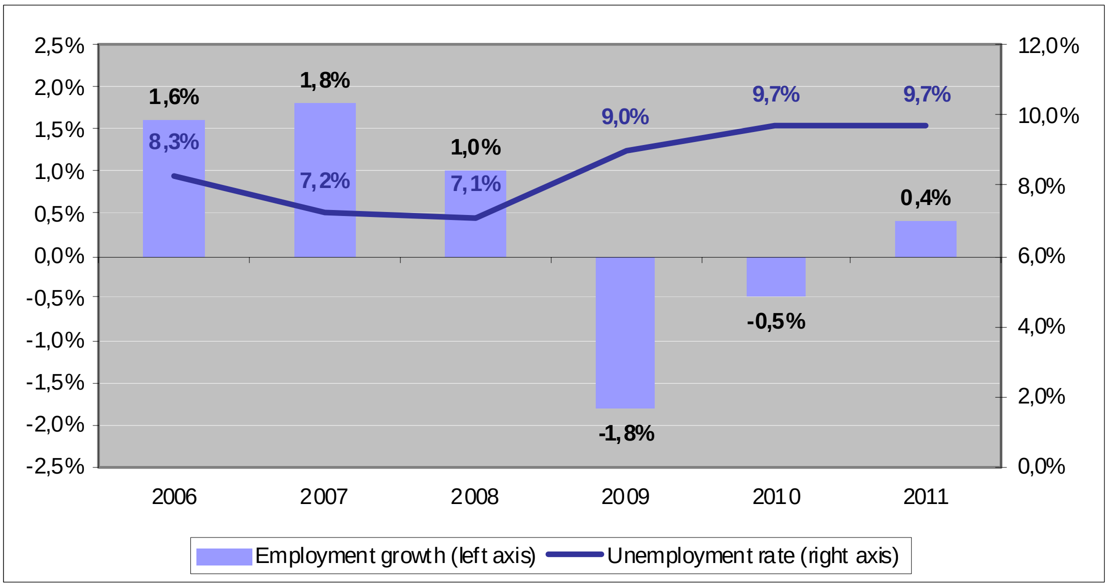
[1] The figures for the past may appear slightly different due to periodic revisions carried out by Eurostat.

the unemployment rate. In both the euro area and the EU, the unemployment rate in 2010 and 2011 fluctuated only marginally.

Although slightly revised upwards, the unemployment rate within the EU is projected to remain stable in 2011 at the same level of 9.7% as in 2010 according to the Autumn Forecast (see Figure below). These figures remain in line with the Spring Forecast that projected the unemployment rate within the EU to decrease slightly in 2011 and to reach a level of 9.5%.

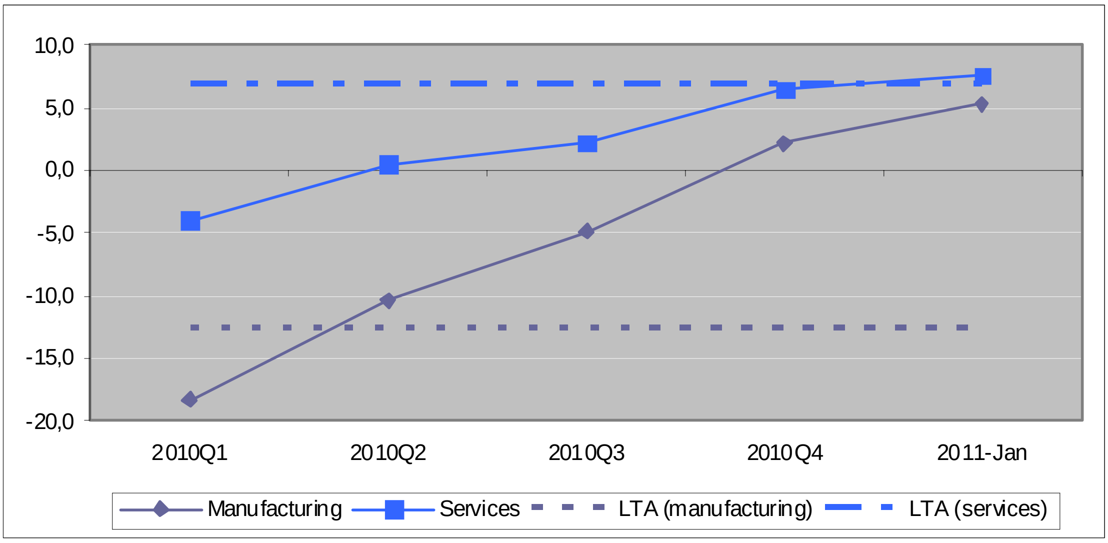
It is in this regard especially noticeable that employment growth is expected to be positive within the EU in 2011 (0.4%) after decreasing for two years (-1.8% in 2009 and -0.5% in 2010).

Figure 2: Employment growth and unemployment rate within the EU-27 (2006 – 2011)



Source: Eurostat (2006-2010) and DG ECFIN (2011)

Figure 3: Employment expectations within the euro-area in 2010 – 2011 (balance)



Source : DG ECFIN

2.3. Compensation of employees in the private sector and in the total economy is increasing in 2010 and in 2011

The Commission considers that it may be useful to compare the situation of employees in the public sector to the total economy in the EU. For this purpose, we may consider the compensation of employees, which measures the total labour cost for all employees, defined as gross wages including overtime and bonuses, together with benefits received in kind and employer social contributions[2], both in the public sector (general government sector[3]) and in the total economy.

The 2011 Autumn European Economic Forecast expected the compensation of employees in the total economy to increase at annual rates of 2-3% in the upcoming years.

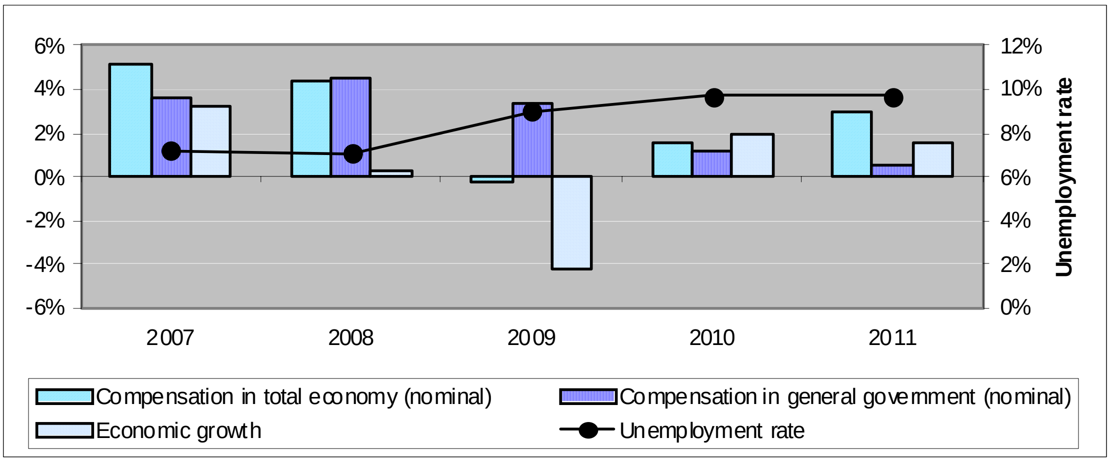
In the previous years the compensation of employees in the total economy increased by 5.2 % in 2007 and 4.4 % in 2008 but dropped by 0.3 % in 2009 at the heart of the financial turmoil, while GDP fell by 4.2 %. For 2011, the compensation of employees in total economy is expected to increase to 3.0%, which is above the figure forecasted in spring (2.4%).

The annual increase in compensation of employees in the public sector fell from 3.4 % in 2009 to 1.2 % in 2010. According to the Autumn Forecast this trend is expected to continue in 2011 (0.6 %). In real terms, the compensation for employees in the public sector is expected to be -2.2%, which is in line with the loss of purchasing power of national officials measured by the method (-1.8%), which is to be applied to EU civil servants.

2 As a consequence, it reflects changes in the employment rate and changes in welfare policy as well as the wage level.

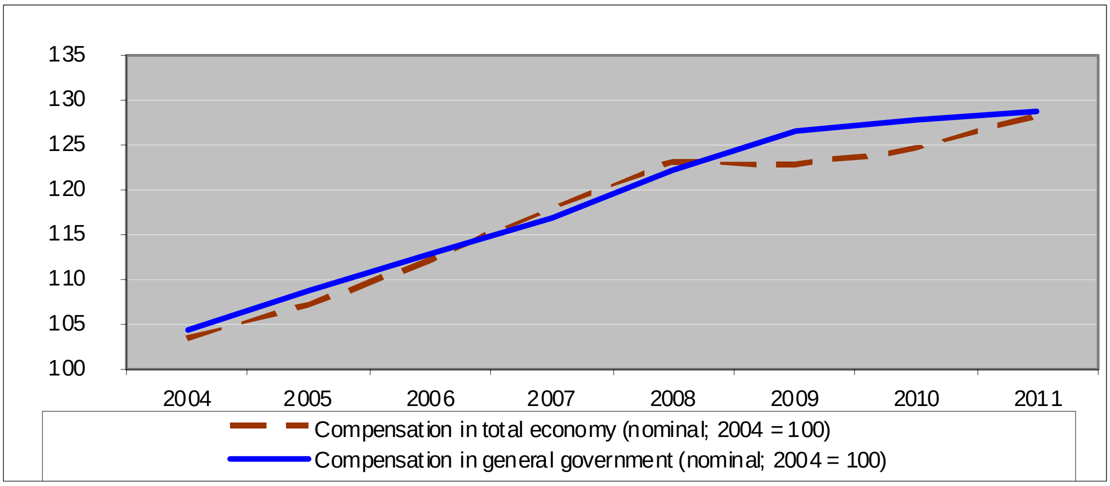
3 The public sector stands for general government throughout this section. The general government sector includes all institutional units which are other non-market producers whose output is intended for individual and collective consumption, and mainly financed by compulsory payments made by units belonging to other sectors, and/or all institutional units principally engaged in the redistribution of national income and wealth. Institutional units include general government entities and some non-profit institutions and autonomous pension funds. The general government sector is divided into four sub-sectors: central government, state government, local government and social security funds.

Figure 4: Changes in compensation of employees within the EU-27, total economy versus general government (2007 – 2011)



Source: Eurostat (2007-2010) and DG ECFIN (2011)

Figure 5: Cumulative changes in compensation of employees in the EU, total economy versus general government (2004 – 2011)



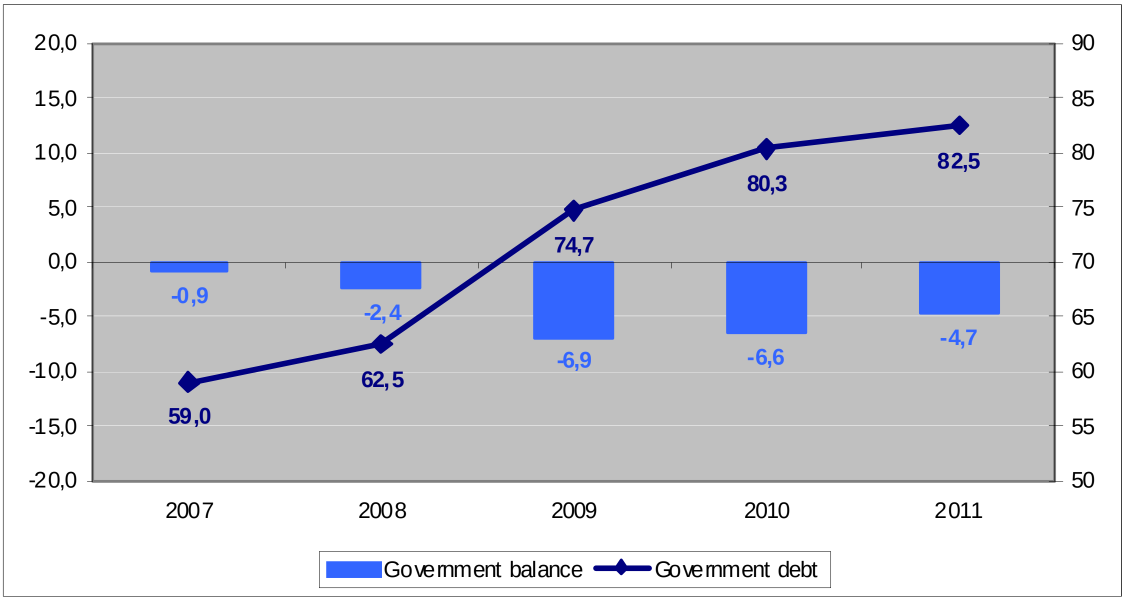
Source: Eurostat (2004-2010) and DG ECFIN (2011)

2.4. Public finances are a matter of concern

2011 marks the change from stabilisation to consolidation of public finances. After decreasing from 6.9% in 2009 to 6.6% in 2010, general government deficit within the EU is therefore projected to decrease further. Fiscal deficit outcomes for 2011 are now projected at 4.7% of GDP in the EU and 4.1% in the euro area. Further consolidation measures that are likely, but not yet enacted, have been disregarded in the Autumn Forecast.

Costly interventions of Member States have significantly impacted public finances although the origin of public debts in most Member States dates back before the last crisis. Overall, public debt reached 80.3% of GDP in 2010 within the EU and is expected to remain at a similar level in 2011 (82.5% of GDP) according to the Autumn Forecast (see Figure below). Public debt figures have remained the same as in the Spring Forecast (82.3% of GDP in 2011).

Figure 6: General government balance and public debt within the EU-27, in % of GDP (2007 – 2011)



Source: Eurostat (2007-2010) and DG ECFIN (2011)

All in all, the issue of public finances remains a major concern for the EU and the Euro area in particular. This concern stems from at least 2007, with measures to adjust public finances under way. Although these measures have led to the gradual improvement of the general government balance, recent developments showed that the impact of rising debt on the sustainability of public finances and their knock-on effect on sovereign debt markets are the key challenge. The weaker economic growth led to a deterioration of budgets and shifted attention to the sustainability of public finances. This is the main reason for expecting salary freezes or only modest salary increases in the public sector of the European Union.

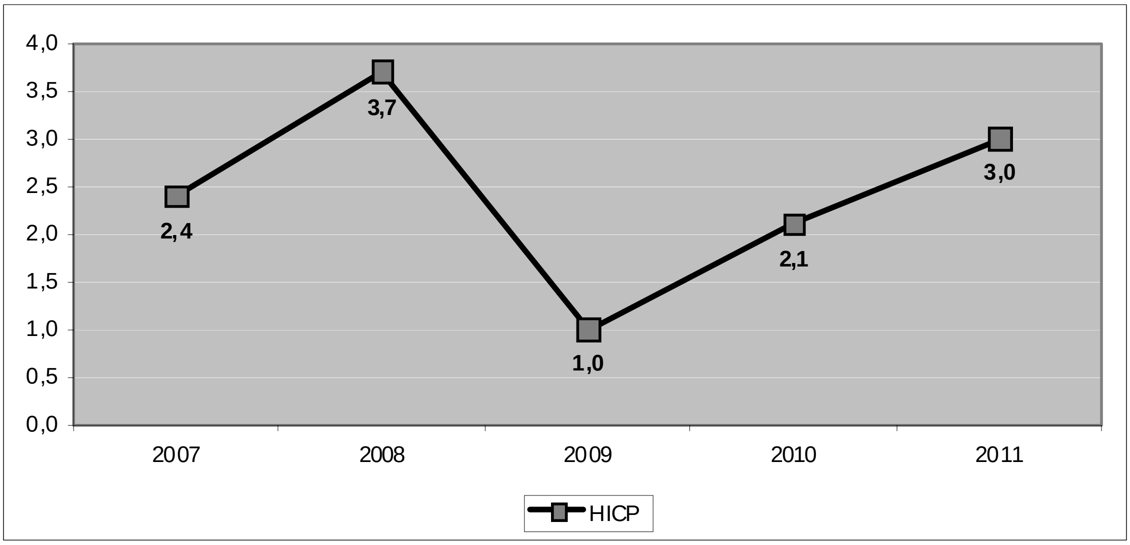
However, the consequences of the turmoil in public finances will continue to be felt for a long time by civil servants in the Member States, because of the need to make significant fiscal retrenchments in the coming years. This will without any doubt have a direct impact on the salaries of EU officials, which will, through the application of the method, precisely follow any salary changes for national officials.

2.5. Inflation remains subdued

Headline HICP inflation accelerated in the first half of 2011, mainly driven by the pass-through of high energy and food commodity prices. As commodity prices have peaked in the first half of 2011, and oil futures prices point to a gradual further decrease going forward, headline inflation is expected to gradually abate, falling back below 2% in the course of 2012. As for the underlying price pressures, persistent output gaps, which are expected to widen slightly in most Member States in 2012, will continue to hold back inflation, while wages are expected to grow only moderately in view of high unemployment.

HICP is expected to rise to 3.0% in 2011 according to the Autumn Forecast (in line with the Spring Forecast).

Figure 7 : Harmonised index of consumer prices within the EU-27 (annual % change)



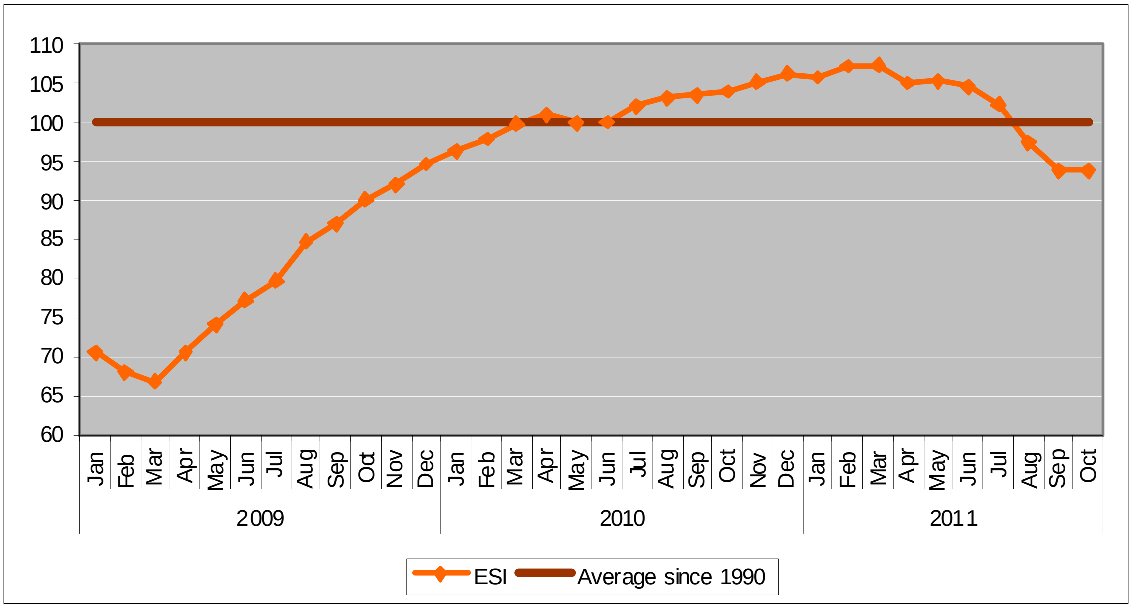
Source: Eurostat (2007-2010) and DG ECFIN (2011)

2.6. Economic Sentiment Indicator has declined

This indicator is extremely volatile. Indeed, after reaching its lowest value since 1990 in March 2009 (66.9), the Economic Sentiment Indicator[4] overtook its average value over 1990–2010 in April 2010 (100 by definition). It reached a peak in March 2011 (107.4), but showed strong declines in the past months (93.8 in October 2011), although remaining well above the lowest values experienced in 2009.

4 Business and consumer surveys provide monthly judgments and expectations concerning diverse facets of economic activity in the different sectors of the economy: industry, services, construction and retail trade, as well as consumers. For each of the five surveyed sectors, 'confidence indicators' are produced to reflect overall perceptions and expectations at the individual sector level in a one-dimensional index. In order to be able to track overall economic activity, the broader Economic Sentiment Indicator (ESI) has been calculated since 1985, as a weighted sum of these five indicators.

Figure 8: Economic sentiment index within the EU-27 (Average since 1990 = 100)



Source : DG ECFIN

3. CONCLUSIONS

In accordance with the exception clause laid down in Article 10 of Annex XI to the Staff Regulations, the Commission is to examine whether there is a sudden and serious deterioration in the economic and social situation within the Union assessed in the light of objective data.

Moreover, according to the judgment of the Court of Justice in Case C-40/10, the Commission must assess whether the above economic and social data is to be qualified as "an extraordinary situation" "where under the normal method the remuneration of officials would not be adjusted quickly enough".

As the Commission assessed in its Report of the 13 July 2011, *'Deterioration'* is a term used to describe a worsening of the economic and social situation. Whether a *'serious'* deterioration of the economic and social situation has occurred should be determined with reference to both the magnitude and duration of the identified economic and social impacts. Whether a *'sudden'* deterioration of the economic and social situation has taken place has to be considered with regard to the speed and predictability of the economic and social impacts. In this context it is particularly important to distinguish normal fluctuations of the economic cycle from those caused by external events.

The forecasts released by DG ECFIN on 10 November 2011 show worsening trends for 2011 as compared to the Forecast released in spring both as regards economic and social indicators and that the European economy is currently experiencing a turmoil.

However, despite short-term indicators pointing to an ongoing slowing of economic activity in the EU, the overall growth performance for this year is still relatively strong. In particular, GDP is forecasted to continue to grow in 2011 along a trend at around 1.6% similar to the level of 2010 (2.0%) while, as a matter of comparison, it decreased by 4.2% in 2009. The forecasted standstill in the last quarter of 2011 is expected to be limited to that quarter with a modest GDP growth being expected for the first quarter 2012.

In addition, the unemployment rate remains stable in 2011 at the same level as in 2010 (9.7%) while employment growth is expected to be positive for the first time in 2011 (0.4%) after decreasing for two years (-1.8% in 2009 and -0.5% in 2010).

The compensation in total economy is forecasted to remain at a high level in 2011 (3.0%), while in the public sector the figure is much lower (0.6%) and in line with the loss of purchasing power for EU officials as calculated by the method (-1.8% in 2011).

General government deficit within the EU is projected to decrease further from close to 7% in both 2009 and 2010 to 4.7% in 2011 according to the Autumn and Spring Forecasts. Fiscal consolidation is forecasted to progress with public deficits set to decline, even though EU public debt remains a constant concern for the EU economy at least since 2007.

Even though the Autumn Forecast for 2011 clearly describes a less favourable economic and social context than the Spring Forecast, it follows from the criteria set out in Article 10 of Annex XI to the Staff Regulations as interpreted by the Court of Justice that the EU is not facing <u>an extraordinary situation with regard to the method</u> as defined by the Court, where, under the ‘normal method’, the remuneration of EU officials would not be adjusted quickly enough to take account of measures taken by the Member states for national civil servants. In addition, although there would be a relatively high increase in the compensation of employees in total economy, the increase in the compensation of employees in the general government is expected to be modest which will be reflected by the application of the method.

As regards the projection of the compensation of employees in the general government, this parameter is properly reflected by the application of the method in 2011. The workers of public sector are expected to lose 2.2% of their purchasing power, which is in line with the figures supplied by the Member States about national officials in central government (1.8% loss in purchasing power). This loss in purchasing power would through the method be applied to EU civil servants in all places of employment, and their real salaries would be cut by the same percentage.

The loss in purchasing power of national and EU officials appears in line with the current economic and social situation, and this situation does not justify any measures going beyond that loss. Therefore, the Commission is not in a position to trigger the exception clause without breaching Article 10 of Annex XI to the Staff Regulations and the case law of the European Court of Justice.

This does not exclude, however, to perform structural reforms in the European civil service based on Article 336 TFEU directly. Therefore, the Commission would like to recall its draft proposal for the Review of the Staff Regulations which proposes i.a. a 5% reduction of staff in all institutions and agencies, an increase of the mandatory weekly working time for EU civil servants to 40h without compensatory wage adjustments, an increase of the normal retirement age to 65, a significant restriction of early retirement rules as well as measures related to rules on careers like a significant lowering of salaries for certain functions. This is in line with measures taken or discussed for national civil services and would generate considerable savings of over one billion Euros during the next Multiannual Financial Framework and of even higher amounts beyond 2020.

More specifically in order to address the recent financial turmoil and the on-going concerns of realising savings in national administrations and cutting national budgets, the Commission has decided to propose an additional increase of the proposed solidarity levy up to 6%. If adopted by the co-legislators, this additional increase would impact salaries of EU civil servants until the end of the proposed revised method of salaries and pension adjustments in 2022.

The Commission will table this proposal formally in December 2011 as soon as the obligatory formal consultation of the Staff Regulations committee has been concluded.

Finally, the Commission would like to come back to the fact that the economic growth in the EU is expected to come to a standstill in the last quarter of 2011 and very modest economic growth is expected in 2012. If the economic situation continues deteriorating further and triggers actions by the Member states at national level which could not be covered fast enough by the normal application of the method, the Commission, in accordance with the principle of loyal cooperation as underlined by the Court of Justice, will use the exception clause to take due account of these measures at national level and also to reduce the time lag between these measures coming into force and the next annual adjustment.