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REPORT FROM THE COMMISSION TO THE COUNCIL

on the exception clause (Article 10 of Annex XI to the Staff Regulations)

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EXECUTIVE SUMMARY

During the discussions on the 2010 annual adjustment of the remuneration and pensions of EU staff the Council stated that the latest financial and economic crises had resulted in a serious and sudden deterioration of the economic and social situation within the EU and requested the Commission to submit appropriate proposals on the basis of Article 10 of Annex XI to the Staff Regulations.

In the judgment rendered on 24 November 2010 in Case C-40/10, the Court of Justice stressed that the exception clause 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. The Court clarified that the procedure laid down in Article 10 of Annex XI to the Staff Regulations constitutes the only means of taking account of an economic crisis in the adjustment of remuneration and therefore of disapplying the criteria laid down in Article 3(2) of that Annex.

The method thoroughly measures, through the principle of parallelism, the relevant economic and social situation within the Union, as reflected in decisions of Member States on the salaries of national civil servants. The legislator carefully chose the criteria to be taken into account for the adjustment of remuneration and pensions; these criteria can be applied during both an upswing and a downturn in the economy.

The exception clause is not an economic cycle clause: it is therefore to be used when there are extreme developments in the EU and only if the method is not able to measure them. It is not to be used whenever the EU is in the downward phase of the economic cycle.

The Commission has used 15 indicators to assess whether it is necessary to use the exception clause in 2011. In line with the European Economic Forecasts released by DG ECFIN on 13 May 2011, they show that the economic recovery in the EU continues to make headway.

The report concludes that there has 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, and that it is not appropriate to submit a proposal under Article 10 of Annex XI to the Staff Regulations.

However, on 29 June 2011, the Commission took note of a draft proposal for a new method, including possible amendments to the mechanism of the exception clause, in order to render its application automatic under specific conditions in the future.

1. INTRODUCTION

During the discussions on the 2010 annual adjustment of the remuneration and pensions of EU officials and other servants, the Council made the following statement:

The Council notes that the latest financial and economic crises that have occurred within the EU and that result in substantial fiscal adjustments and increased job uncertainty in several Member States create a serious and sudden deterioration of the economic and social situation within the EU. In this context, the Council requests the Commission, in conformity with Article 241 TFUE, to submit, on the basis of Article 10 of Annex XI of the Staff Regulations and in the light of objective data supplied by the Commission, appropriate proposals in time for the European Parliament and the Council to examine and adopt them before the end of 2011.

Under Article 241 TFEU, the Council, acting by simple majority, may request the Commission to undertake any studies the Council considers desirable for the attainment of the common objectives, and to submit to it any appropriate proposals. If the Commission does not submit a proposal, it must inform the Council of the reasons.

This report complies with the Council's request and with Article 241 TFEU. It covers the period starting from the effective date of the last annual adjustment of remuneration and pensions (1 July 2010) until the moment when the latest data were made available for the purposes of this report (mid-May 2011).

2. LEGAL BACKGROUND

Under Article 65 of the Staff Regulations, '*... [t]he Council shall each year review the remuneration of the officials and other servants of the Union. This review shall take place in September in the light of a joint report by the Commission based on a joint index prepared by the Statistical Office of the European Union in agreement with the national statistical offices of the Member States; the index shall reflect the situation as at 1 July in each of the countries of the Union.*

During this review the Council shall consider whether, as part of economic and social policy of the Union, remuneration should be adjusted. Particular account shall be taken of any increases in salaries in the public service and the needs of recruitment.'

Pursuant to Article 65a of the Staff Regulations, the rules for implementing Articles 64 and 65 are set out in Annex XI.

Article 3(1) and (2) of Annex XI to the Staff Regulations states:

1. Under Article 65(3) of the Staff Regulations, the Council, acting on a Commission proposal and on the basis of the criteria set out in Section 1 of this Annex, shall take a decision before the end of each year adjusting remuneration and pensions, with effect from 1 July.

2. The amount of the adjustment shall be obtained by multiplying the Brussels International Index by the specific indicator. The adjustment shall be in net terms as a uniform across-the-board percentage.

Article 10 of Annex XI to the Staff Regulations (the exception clause) stipulates:

If there is a serious and sudden deterioration in the economic and social situation within the Union, assessed in the light of objective data supplied for this purpose by the Commission, the latter shall submit appropriate proposals on which the European Parliament and the Council shall decide in accordance with Article 336 of the Treaty on the Functioning of the European Union.

The relationship between Article 3 of Annex XI and the exception clause was analysed by the Court of Justice in its judgment in Case C-40/10 Commission *v* Council. The Court pointed out that the exception clause *'... makes it possible, in an extraordinary situation, to disregard on an ad hoc basis the method laid down in Article 3 of Annex XI to the Staff Regulations, without amending it or repealing it for the following years'* (paragraph 74, underlining added).

In addition, the Court explained that *'... as the Commission considered in its report of 27 June 1994 on the applicability of the exception clause (SEC(94) 1027 final, point II.3, pp. 5 and 6), that clause 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, underlining added).

The Court of Justice made it clear that: *'... the procedure laid down in Article 10 [of Annex XI to the Staff Regulations] constitutes the only means of taking account of an economic crisis in the adjustment of remuneration and therefore of disapplying the criteria laid down in Article 3(2) of that annex'* (paragraph 77, underlining added).

That finding cannot be invalidated by the fact that the application of Article 10 of Annex XI to the Staff Regulations is dependent on a proposal from the Commission. It is clear inter alia from Article 17(2) TEU that that situation is consistent with the institutional balance envisaged by the Treaties which, in principle, grant the Commission, in respect of legislative procedures, the sole power to initiate proposals' (paragraph 78).

3. THE OBJECTIVES AND THE UNDERLYING PRINCIPLES OF THE METHOD

The Commission considers it appropriate to recapitulate the principles underlying the method for salary and pension adjustments, which were already explained in the Commission Report on Annex XI to the Staff Regulations (COM(2008) 443).

The provisions of the current method for adjusting remuneration and pensions apply from 1 July 2004 until 31 December 2012 and are laid down in Articles 64, 65 and 65a of and Annex XI to the Staff Regulations.

The main objectives of the method are:

– automatic salary adjustment in order to avoid that the work of all Union Institutions and agencies is disrupted by annual negotiations and possibly strikes;

– transparent, efficient, relatively straightforward rules to determine salary adjustments for officials and other servants of all EU Institutions.

In order to ensure that the method functions properly, the following principles have been laid down:

– equality of purchasing power among EU civil servants in different duty stations;

– parallelism with national officials in terms of changes in purchasing power.

Two aspects of the method should be examined more closely:

– the principle of parallelism;

– the time-lag.

3.1. The principle of parallelism

In accordance with Article 1(4) of Annex XI, the (global) specific indicator is calculated to reflect the average change in the net remuneration of national officials in central government in real terms, i.e. after taking account of inflation in the country where they work. Then, as laid down in Article 3(2) of Annex XI, consumer price inflation in Brussels, which is the reference location where most EU officials work, is measured by the Brussels International Index (BII). Finally, the BII is multiplied by the global specific indicator to calculate the nominal annual adjustment to the basic salaries of EU officials, which may be either positive or negative.

Therefore, the change in the purchasing power of EU officials is fully determined by the global specific indicator, which ensures equivalence with developments in the purchasing power of national officials. This is the principle of parallelism.

3.2. The time-lag inherent in the method

In line with Articles 1(2) and (4) of Annex XI to the Staff Regulations, the Brussels International Index is to take into account the changes in consumer prices between June of the previous year and June of the current year, and Eurostat is to calculate specific indicators reflecting changes in the real remuneration of civil servants in central government, for the countries in the sample, between 1 July of the previous year and 1 July of the current year. Under Article 3(1) of Annex XI to the Staff Regulations, the Council, acting on a Commission proposal, has to take a decision before the end of each year adjusting remuneration and pensions, with effect from 1 July. Therefore, the annual adjustment applies with a maximum delay of one year. There is then a further delay of up to six months until adoption of the salary adjustment regulation, required before 31 December, which is applied retrospectively.

The legislator considered that the method could function with this time-lag, and EU officials and other staff would be able to bear the impact of yearly inflation. That is why Article 65 lays down only one annual deadline for the adjustment of remuneration. There is, however, the possibility to make an intermediate adjustment of remuneration, provided for in Articles 4-8 of Annex XI to the Staff Regulations, if there is a substantial change in the cost of living between June and December.

4. EXCEPTION CLAUSE

Nevertheless, the legislator adopted an exception clause. This clause sets a number of conditions that have 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, and it must be assessed in the light of objective data provided by the Commission;

– 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.

The exception clause stipulates that, if there are objective reasons for it to be triggered, the Commission is bound to submit appropriate proposals on which the European Parliament and the Council are to decide in accordance with Article 336 TFEU.

4.1. Conditions for triggering the exception clause

The wording of the exception clause should be carefully examined since, in order to trigger the clause, all the conditions laid down in Article 10 of Annex XI to the Staff Regulations must be met.

'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.

Whether the above conditions are met should be assessed by using a variety of objective indicators, covering both the economic and the social domains. These indicators should comply with the following set of relevant and widely accepted principles[1].

– An indicator should capture the essence of the problem and have a clear and accepted normative interpretation.

[1] Most of them are principles agreed for the Open Method of Coordination (OMC) on social inclusion and protection. The OMC is used by Member States to support the definition, implementation and evaluation of their social policies and to develop their mutual cooperation. A tool of governance based on common objectives and indicators, the method supplements the legislative and financial instruments of social policy. It is part of the implementation of the process of coordination of social policies, particularly in the context of the Lisbon Strategy (and now Europe 2020).

– An indicator should be robust and statistically validated.

– An indicator should be timely and susceptible to revision.

– The focus of indicators should be on the EU as a whole and not on individual Member States.

– The indicators should be mutually consistent.

– The set of indicators should be as transparent and accessible as possible to EU citizens.

– Recourse should be made to existing indicator sets wherever possible.

In accordance with these principles, the following 15 indicators are appropriate:

– Economic activity: GDP growth, domestic demand, inventories, net exports, private consumption, public consumption, total investment, and inflation (HICP) within the Union;

– Public finances: general government balance and public debt within the Union;

– Labour market: total employment, unemployment rate and compensation of employees within the Union;

– Sentiment indicators: Economic Sentiment Indicator and employment expectations within the Union.

In order to assess whether the criteria laid down in the exception clause are currently met, the analysis of the economic and social situation should be carried out for the period from July 2010 to mid-May 2011 (subject to the availability of relevant data or forecasts), as the 2010 annual adjustment already covered the period until 1 July 2010. This is in line with the definition of a 'sudden' deterioration, referred to in Article 10 of Annex XI to the Staff Regulations. However, a longer period is presented to provide a global overview where appropriate.

4.2. Retaining the principle of parallelism

The method thoroughly measures, through the principle of parallelism, the relevant economic and social situation within the Union, as reflected in decisions of Member States on the salaries of national civil servants. The legislator carefully chose the criteria to be taken into account for the adjustment of remuneration and pensions; these criteria can be applied during both an upswing and a downturn in the economy.

The method for adjusting remuneration and pensions has been in force for almost forty years. During this long period of time, the EU economy has experienced periods of rapid growth as well as periods of economic downturn.

The principle of parallelism with national officials in terms of changes in purchasing power, which has been enshrined in the Staff Regulations since 1962, has to be maintained also at a time of economic downturn in the European Union. This is fully in line with Article 65, which states that particular account is to be taken of any increases in salaries of the public service during the annual review.

However, if there is a sudden and serious deterioration that the method would not be able to take properly into account, due to its exceptional nature in terms of either timing or magnitude, the exception clause should be used.

A different interpretation would lead to incoherent results: despite the method's ability to capture properly economic and social developments within the EU through their effect on salaries of national civil servants, the legislator would have to adopt exceptional measures with respect to the annual adjustment of EU civil servants' remuneration and pensions. Such an interpretation would fall outside the economic and social policy of the European Union, as referred to in Article 65 of the Staff Regulations.

The same applies to the time-lag inherent in the method. The reference period, by definition, entails a maximum delay of one year in salary adjustments (although the delay in practice is likely to be smaller). While the legislator considered that the method should work with this time-lag, the exception clause clearly makes it possible to decrease it, if Member States were to take extreme measures to adjust the salaries of national officials, which should be applied to EU civil servants without waiting for the following annual adjustment exercise.

Therefore, the appropriate proposals, where necessary, should be such as to reflect the exceptional developments that have not been properly captured by the method. These proposals should not go beyond the implementing rules laid down in Annex XI to the Staff Regulations: there is no objective reason to apply criteria other than the change in purchasing power in the Member States' civil services, because that would undermine the effects of the method and would impose additional measures on EU staff which had not been applied to staff in the Member States.

Lastly, the exception clause is not an economic cycle clause. As explained above, the legislator carefully chose the economic and social criteria to be taken into account for salary and pension adjustments; these criteria can be applied at a time of economic growth as well as at a time of economic downturn. The method can be applied equally when salaries in Member States increase or decrease, and the gain or loss in the purchasing power of national civil servants will be directly reflected in the salaries and pensions of EU civil servants. Hence, the exception clause is to be used when there are extreme developments in the EU and only if the method is not able to measure them. It is not to be used whenever the EU is in the downward phase of the economic cycle.

5. THE ECONOMIC AND SOCIAL SITUATION IN THE EU

Like most financial stress-driven crisis episodes, the recent crisis was preceded by a relatively long period of rapid credit growth, low risk premiums, soaring asset prices and above all the development of bubbles in the real estate sector. Failure by some banks to value their investment funds already in the summer of 2007 confirmed the suspicion that a financial crisis could occur, due to the heavy exposure of banks to

American subprime mortgage loans, a few months before the crisis truly broke out in 2008.

Public authorities still perceived the emerging crisis as a liquidity problem and systemic collapse was deemed unlikely, until the events of September 2008 led them to react vigorously so as to rapidly restore calm in the financial markets.

In the meantime, appropriate macroeconomic policy responses helped limit the duration of the crisis and set the scene for the economic recovery[2].

In order to determine whether the chosen reference period (1 July 2010 to mid-May 2011) is the most appropriate for assessing whether the exception clause should be applied, the developments prior to this period should be briefly examined.

5.1. The preceding period

5.1.1. Annual adjustments in 2009 and 2010

Over the period July 2008–July 2009, the global specific indicator showed a 2.7% increase in the purchasing power of national civil servants in central government (see Table 1). This increase and the Brussels International Index (BII) (0.9%) added up to a 3.7% adjustment value for July 2009–July 2010, due to the time-lag inherent in the method (see Table 2). Through parallelism, the increase in purchasing power of European officials over July 2009–July 2010 equals that of national officials over the preceding one-year period (2.7%).

Table 1: Change in net remuneration over July 2008 – July 2009, representative sample (%)

	BE	DE	ES	FR	IT	LU	NL	UK	EU8
Nominal change	3,4	3,1	3,3	1,8	3,0	3,5	3,7	2,1	3,0
Inflation (HICP)	-1,0	0,0	-1,0	-0,6	0,6	-1,0	1,4	1,8	0,3
Real change	4,4	3,1	4,3	2,4	2,4	4,5	2,3	0,3	**2,7**

Source : *Eurostat*

Table 2: Annual adjustment in 2009 (%)

	EU officials
Annual adjustment *(Nominal change)*	3,7
BII *(Brussels inflation)*	0,9
Specific indicator *(Real change)*	**2,7**

Source : *Eurostat*

Over the period July 2009–July 2010, six out of the eight Member States used in the sample adopted increases in nominal salaries (see Table 3). On average, these amounted more or less to a freeze on nominal salaries (-0.6% including the French

2 Source: *Economic crisis in Europe: Causes, consequences and responses*, July 2009, DG ECFIN.

correction; -0.3 % in reality[3]). Mainly due to inflation (1.7 %), this resulted in a fall in purchasing power of national officials (-2.2 %). Through parallelism, it was automatically reflected in the 2010 review when the remuneration of European officials was also frozen[4] (see Table 4).

Table 3: Change in net remuneration over July 2009 – July 2010, representative sample (%)

	BE	DE	ES	FR	IT	LU	NL	UK	EU8
Nominal change	0,9	-4,1	-1,3	0,3	0,6	1,9	0,7	1,9	-0,6
Inflation (HICP)	2,7	0,8	1,5	1,7	1,5	2,3	0,2	3,2	1,7
Real change	-1,8	-4,9	-2,8	-1,4	-0,9	-0,4	0,5	-1,3	**-2,2**

Source : Eurostat

Table 4: Annual adjustment in 2010 (%)

	EU officials
Annual adjustment *(Nominal change)*	0,1
BII *(Brussels inflation)*	2,4
Specific indicator *(Real change)*	**-2,2**

Source : Eurostat

The Member States making up the sample adopted salary adjustments during the period 2007-2010 which cannot be reasonably considered as likely to produce excessive results given the time-lag built into the method: these adjustments led at most to a 2.2 % decrease in purchasing power over the period July 2009–July 2010. At the same time, other Member States, in particular the new ones, made salary cuts (see Table 5). Overall, the specific indicator for 27 Member States would amount to -2.0 %, which would have resulted in an even higher adjustment value for EU salaries. According to Eurostat's March 2011 estimates, a further decline of 1.3 % is projected for the period July 2010–July 2011.

If salary cuts had been implemented by many Member States, representing a significant proportion of EU GDP and therefore, by definition, reflected in the global specific indicator, the Commission would have submitted appropriate proposals in order to bring forward the loss of purchasing power for EU officials.

3 The impact of an error in the French figures related to the 2009 adjustment was taken into account in the 2010 adjustment, as the correction of the 2009 adjustment was not possible due to the need to comply with the judgment in Case C-40/10.

4 A slight increase in basic salaries of 0.1 %, which, after taking into account the increase in the pension contribution rate and in the special levy, resulted in a cut in net salaries.

Table 5: Change in net remuneration over July 2009 – July 2010, EU-27 (%)

	BE	BG	CZ	DK	DE	EE	EL
Nominal change	0,9	0,0	-1,1	2,7	-4,1	0,0	-7,1
(Change in HICP)	2,7	2,5	1,0	1,7	0,8	0,0	5,2
Real change	-1,8	-2,4	-2,1	1,0	-4,9	0,0	-11,7
	ES	**FR**	**IE**	**IT**	**CY**	**LV**	**LT**
Nominal change	-1,3	0,3	-4,2	0,6	2,0	-27,0	-13,3
(Change in HICP)	1,5	1,7	-2,0	1,5	2,1	-1,6	0,9
Real change	-2,8	-1,4	-2,2	-0,9	-0,1	-25,8	-14,1
	LU	**HU**	**MT**	**NL**	**AT**	**PL**	**PT**
Nominal change	1,9	7,7	3,3	0,7	2,4	4,2	-0,2
(Change in HICP)	2,3	5,0	1,8	0,2	1,8	2,4	1,1
Real change	-0,4	2,6	1,5	0,5	0,6	1,8	-1,3
	RO	**SI**	**SK**	**FI**	**SE**	**UK**	**EU27**
Nominal change	-1,7	1,0	0,0	3,2	4,5	1,9	-0,3
(Change in HICP)	4,3	2,1	0,7	1,3	1,6	3,2	1,8
Real change	-5,8	-1,1	-0,7	1,9	2,9	-1,3	-2,0

Source : Eurostat

However, the time-lag effect that occurred over this period was not deemed excessive. The amplitude of the time-lag effect can be assessed by determining the difference between the change in purchasing power of national officials and that of EU officials, in a given year. This gap was equal to -4.0% over the period July 2008–July 2009: that is to say that the change in purchasing power of national officials was 4.0 points greater than that of EU officials. The purchasing power of national officials indeed increased by 2.7% over this period, while the purchasing power of EU officials decreased by 1.3%. Over the period July 2009–July 2010, roughly the opposite occurred, with a gap equal to 4.9%, as EU officials benefited, through parallelism, from the increase in purchasing power that had been granted to national officials over the preceding period (see Table 6).

Table 6: Time-lag effect

	Change in purchasing power of national officials (%) (A)	Change in purchasing power of EU officials (%) (B)	Gap (C=B-A)
2004	-1,2	↓	-
2005	0,0	-1,2	-1,2
2006	0,2	0,0	-0,2
2007	0,0	0,2	0,2
2008	-1,3	0,0	1,3
2009	2,7	-1,3	**-4,0**
2010	-2,2	2,7	**4,9**
2011	-	-2,2	-

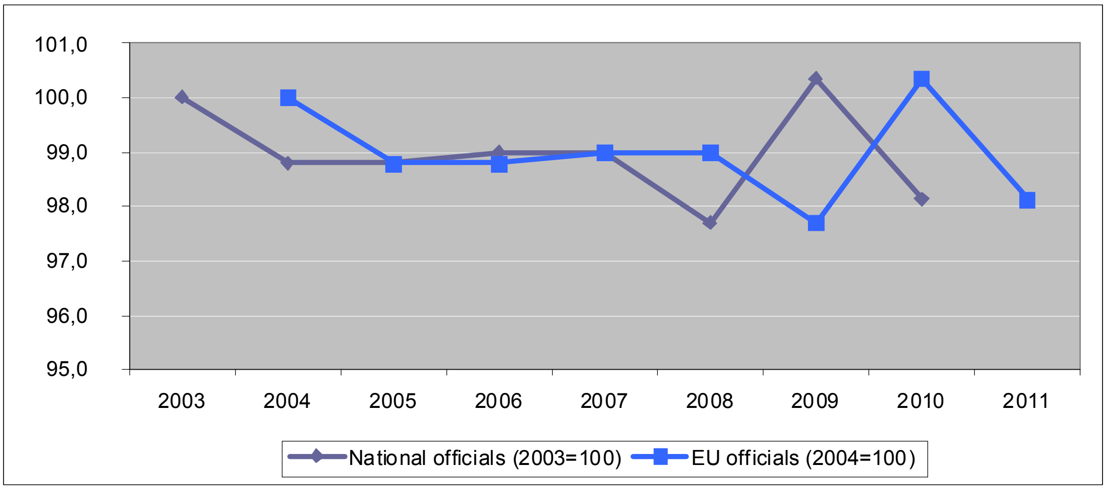
Source : Eurostat

The application of the method in 2009 led to an annual adjustment of 3.7% for EU officials, which the Council deemed inappropriate at that time. However, this increase resulted from the principle of parallelism (as salaries in the national civil services had increased), and the time-lag effect, though noteworthy, was still reasonable and unlikely to impede the proper functioning of the method. Therefore, there was no need to apply the exception clause in 2009.

5.1.2. Departure from the principle of parallelism

In order to apply the principle of parallelism laid down in the method for adjusting the remuneration of EU officials, the change in the salaries of national officials is monitored, and the average change in their purchasing power is applied to determine developments in the purchasing power of EU officials' salaries. However, the annual adjustment calculated by reference to a given 12-month period is taken into account to adjust salaries in the EU civil service during the following year. Therefore, the purchasing power of EU officials follows the average purchasing power of national officials within the Member States making up the representative sample, with a systematic time-lag inherent in the method (see Figure 1, Table 7 and Table 8).

Figure 1: Change in purchasing power of EU officials compared to national officials in central government (2003 – 2011)*



Source : Eurostat

*The curve for EU officials is similar to the curve for national officials, shifted by one year to the right, due to the time-lag. Over 2005 – 2007, the two curves look superimposed because of small values for the specific indicator (close to 0%). Yet, there is still a one-year lag.

Table 7: Annual percentage change in purchasing power of national and EU officials*

Year	Annual % change in purchasing power of national officials	Annual % change in purchasing power of EU officials
2004	-1,2	↘
2005	0,0	-1,2
2006	0,2	0,0
2007	0,0	0,2
2008	-1,3	0,0
2009	2,7	-1,3
2010	-2,2	2,7
2011	-	-2,2

Source : Eurostat

*Changes in pension contributions and special levy are not taken into account

Table 8: Changes in purchasing power of national and EU officials*

Year	Changes in purchasing power of national officials (2003=100)	Changes in purchasing power of EU officials (2004=100)
2003	100,0	↘
2004	98,8	100,0
2005	98,8	98,8
2006	99,0	98,8
2007	99,0	99,0
2008	97,7	99,0
2009	100,3	97,7
2010	98,1	100,3
2011	-	98,1

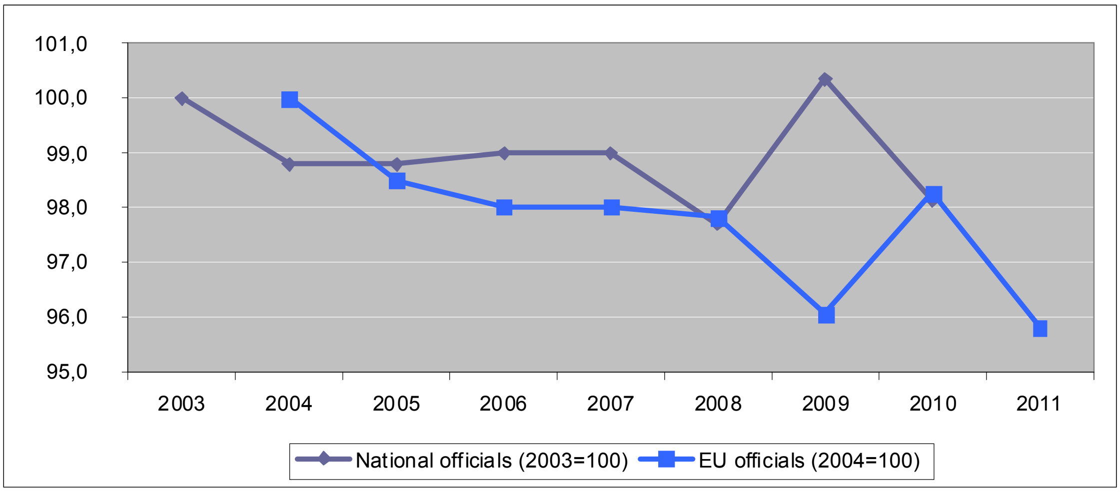
Source : DG HR

*Changes in pension contributions and special levy are not taken into account

Nevertheless, as already pointed out by the Commission in 2008[5], the principle of parallelism is partially invalidated, at the potential expense of EU officials, for two reasons. Although their salaries are affected by changes in national social contributions via the specific indicator, the social contributions paid by EU officials are periodically adjusted on an independent basis. The special levy, which is an additional deduction from the remuneration of EU officials, introduces another element of double-counting. In order to make a proper comparison between the purchasing power of national and EU officials, these items should be taken into account (see Figure 2, Table 9 and Table 10).

5 Report from the Commission to the European Parliament and to the Council on Annex XI to the Staff Regulations, COM(2008) 443 final, 10.7.2008.

Figure 2: Changes in purchasing power of EU officials compared to national officials in central government (2003 – 2011) including pension contributions and special levy



Source : Eurostat

Table 9: Annual percentage change in purchasing power of national and EU officials including the combined effect of increases in pension contributions and special levy

Year	Annual % change in purchasing power of national officials	Annual % change in pension contributions and special levy	Annual % change in purchasing power of EU officials
2004	-1,2	0,3	↘
2005	0,0	0,5	-1,5
2006	0,2	0,2	-0,5
2007	0,0	0,2	0,0
2008	-1,3	0,5	-0,2
2009	2,7	0,4	-1,8
2010	-2,2	0,3	2,3
2011	-	-	-2,5

Source : Eurostat

Table 10: Evolution of purchasing power of national and EU officials including the combined effect of increases in pension contributions and special levy

Year	Evolution of purchasing power of national officials (2003=100)	Cumulative impact of increases in pension contributions and special levy (2003=100)	Evolution of purchasing power of EU officials (2004=100)
2003	100,0	100,0	↘
2004	98,8	100,3	100,0
2005	98,8	100,8	98,5
2006	99,0	101,0	98,0
2007	99,0	101,2	98,0
2008	97,7	101,7	97,8
2009	100,3	102,1	96,1
2010	98,1	102,4	98,3
2011	-	-	95,8

Source : Eurostat & DG HR

As a consequence, the cumulative purchasing power[6] of national officials fell by 1.8% between 2004 and 2010, while that of EU officials fell by 4.3% over the same period.

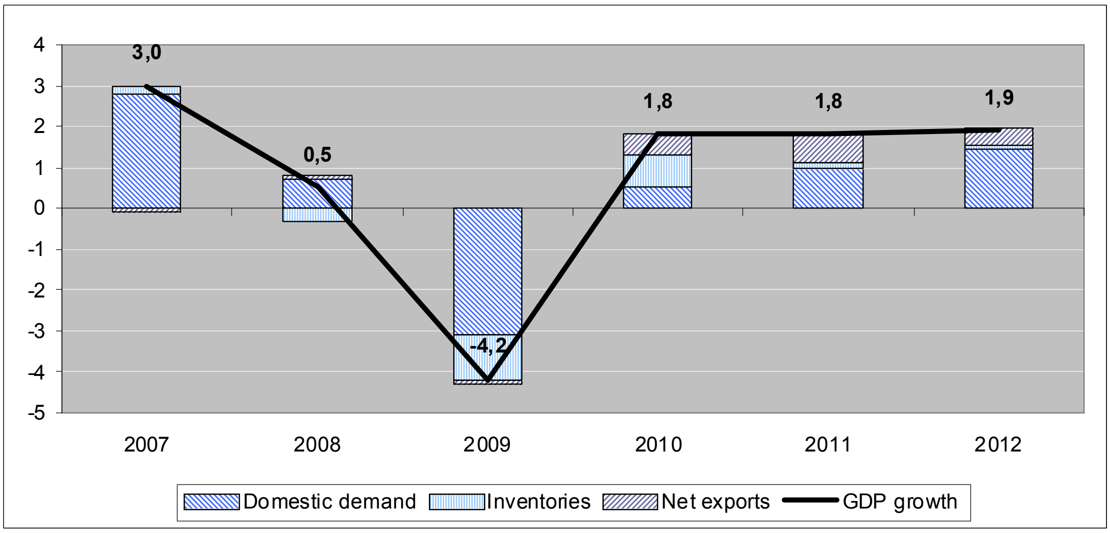
The principle of parallelism should be maintained through economic cycles. This stems from the assumption that Member States would take appropriate measures in respect of their national civil servants, which would have a direct impact on salaries of EU officials. Despite this principle, the remuneration of EU officials has significantly diverged from the remuneration of national officials since 2004, at the expense of the EU civil service.

5.2. Assessment of the EU economic and social situation during the reference period

5.2.1. Economic recovery in the EU is on the way

The recession ended in autumn 2009 and set the scene for a recovery boosted by a strong upturn in the second quarter of 2010, with economic activity expanding by 1% (on a quarter-on-previous-quarter basis in the euro area), broadly due to an export-led rebound in industry. As the pace of growth eased in the third and fourth quarters (0.3%), the EU recovery slowed down in the second half of 2010, as the world economy went through a soft patch and the bad weather conditions in Europe hit investment growth in 2010Q4. Overall for the whole of 2010, GDP increased by 1.8% both in the euro area and in the EU. DG ECFIN's spring forecast confirms the continuing recovery of the EU economy[7]. Economic growth in Europe is expected to continue along a trend at around 1.7% (euro area) and 1.8% (EU) in both 2011 and 2012 (see Figure 3).

Figure 3: GDP growth and decomposition within the EU-27 (annual % change)



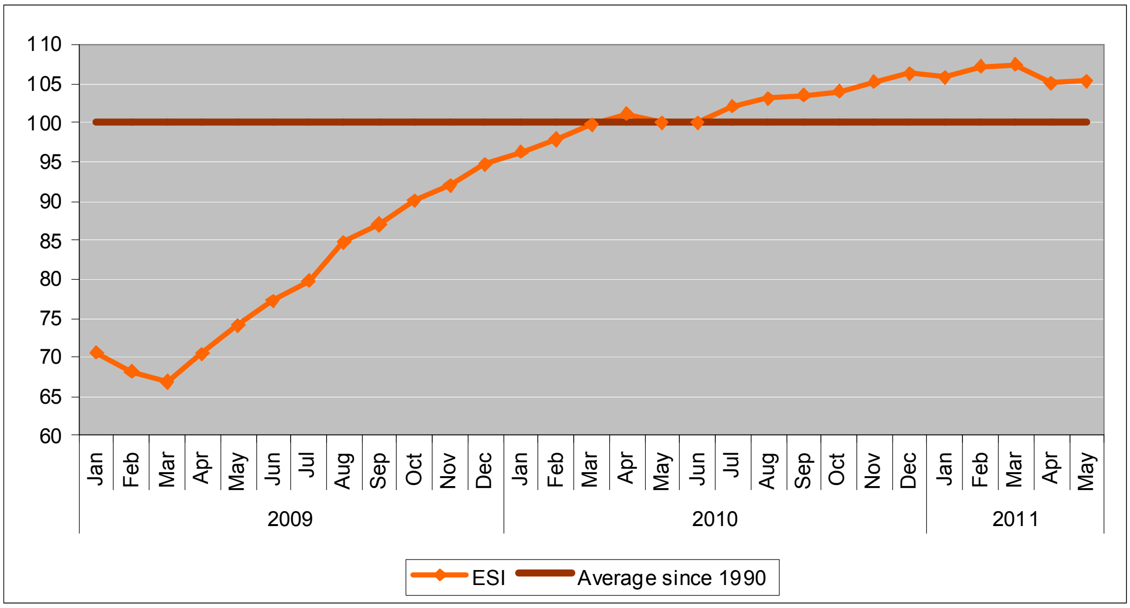
Source : Eurostat (2007-2010) and DG ECFIN (2011-2012)

After reaching its lowest value since 1990 in March 2009 (66.9), the Economic

6 This is computed by compounding the year-on-year change in purchasing power from 2004 to 2010.
7 In the following sections the 2011 and 2012 figures come from DG ECFIN's 2011 spring forecast.

Sentiment Indicator[8] overtook its average value over 1990–2010 in April 2010 (100 by definition). Since then, it increased steadily up to 107.4 in March 2011, but it declined somewhat in April and May 2011 (see Figure 4). This significant rise observed since March 2009 is mainly due to sentiment in industry[9].

Figure 4: Economic sentiment index within the EU-27 (Average since 1990 = 100)



Source : DG ECFIN

The ongoing economic recovery has been driven by exports, which surged by 4.4% (q-on-q) in the second quarter of 2010 before slowing somewhat to 2.2% and 1.8% in Q3 and Q4 respectively. The main contributors to GDP growth in the second half of 2010 were net exports, while developments in investment failed to take over from exports as the main engine of growth. Inventories contributed negatively to GDP growth in the first half of 2010, while during the last quarter of 2010 private consumption showed some encouraging signs (see Figure 5).

Public finances in the EU have deteriorated sharply in recent years. The aggregate general government budget deficit grew from less than 1% of GDP in 2007 to almost 7% of GDP in 2009. This has led to a strong rise in the debt-to-GDP ratio for the EU. However, the deterioration in fiscal positions is not only due to cyclical factors but dates back well before the sharp fall in economic activity in 2008-09. In 2010, the budgetary outturn will not deteriorate further and may even improve slightly as a result of better-than-expected economic growth and as the effect of the fiscal stimulus to support growth comes gradually to an end.

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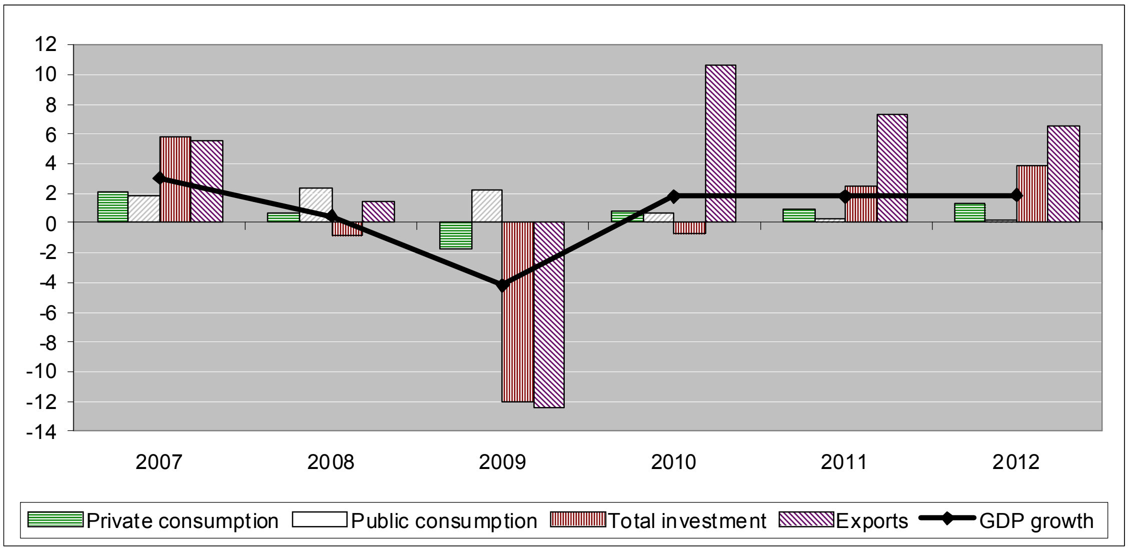
8 Business and consumer surveys provide monthly judgments and expectations concerning diverse facets of economic activity in the different sectors of the economy: industry, services, construction and retail trade, as well as consumers. For each of the five surveyed sectors, 'confidence indicators' are 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.

9 Source: *Business and consumer survey results*, May 2011, DG ECFIN.

Figure 5: Main features within the EU-27 (annual % change)

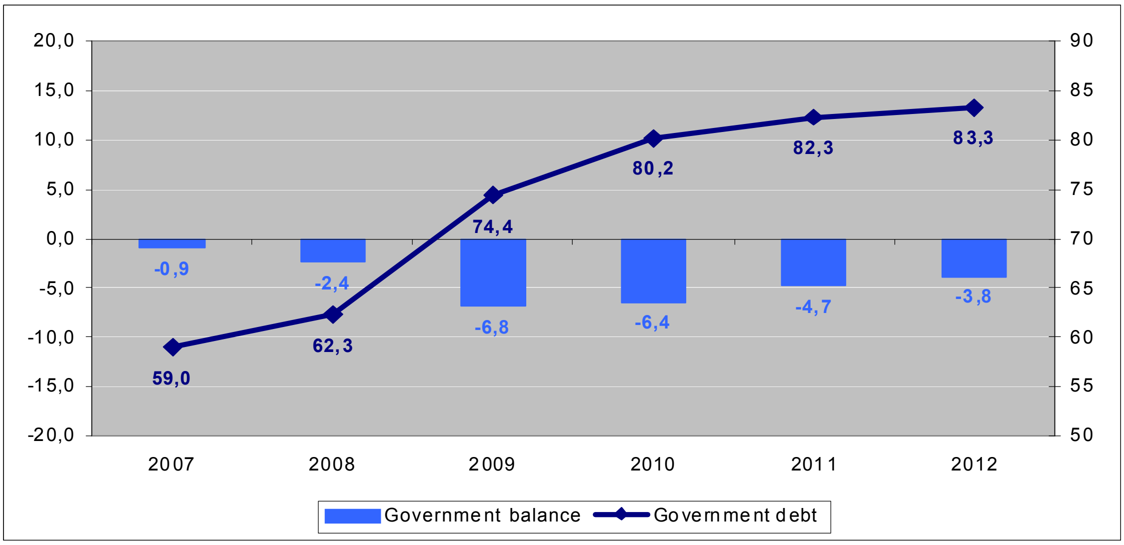


Source : Eurostat (2007-2010) and DG ECFIN (2011-2012)

5.2.2. Public finances start to adjust

The EU's response to the downturn was swift and decisive. Aside from intervention to stabilise, restore and reform the banking sector, the European Economic Recovery Plan (EERP) was launched in December 2008. The objective of the EERP was to restore confidence and bolster demand through a coordinated injection of purchasing power into the economy along with strategic investments and measures to shore up business and labour markets. These costly interventions have significantly impacted public finances: the debt-to-GDP ratio of the four largest European economies exceeds 75%, far above the threshold provided for in the Stability and Growth Pact. Overall, public debt reached 80.2% of GDP within the EU and is expected to remain on an upward trend over the forecast horizon (2011–2012), reaching 83.3% of GDP in 2012 (see Figure 6).

Figure 6: General government balance and public debt within the EU-27, in % of GDP (2007 – 2012)



Source : Eurostat (2007-2010) and DG ECFIN (2011-2012)

In this context, governments have already started to push public finances towards fiscal adjustments and structural reforms: more than half of the Member States are set to post a lower general government deficit in 2010 than in 2009; general government deficit within the EU is projected to decrease from 6.4% of GDP in 2010 to 4.7% in 2011 and 3.8% in 2012. Persistent high levels of debt could indeed undermine the economic recovery, mainly through three channels: higher savings by households, the financing of deficits via distortionary taxation and increases in government risk premia. Also, the credibility effect may offset the negative impact of consolidating, which entails a contractionary effect. The main concern is to avoid renewed turbulence in sovereign-debt markets as experienced in early 2010.

All in all, the economic recovery in the EU appears to be taking hold, with measures to adjust public finances under way, while inflation remains broadly contained[10].

5.2.3. *Inflation remains subdued*

Despite high debt ratios, inflation remains subdued: HICP inflation is expected to average 2.1% in 2010 within the EU and to rise to 3.0% in 2011 before falling to 2.0% in 2012 (see Figure 7).

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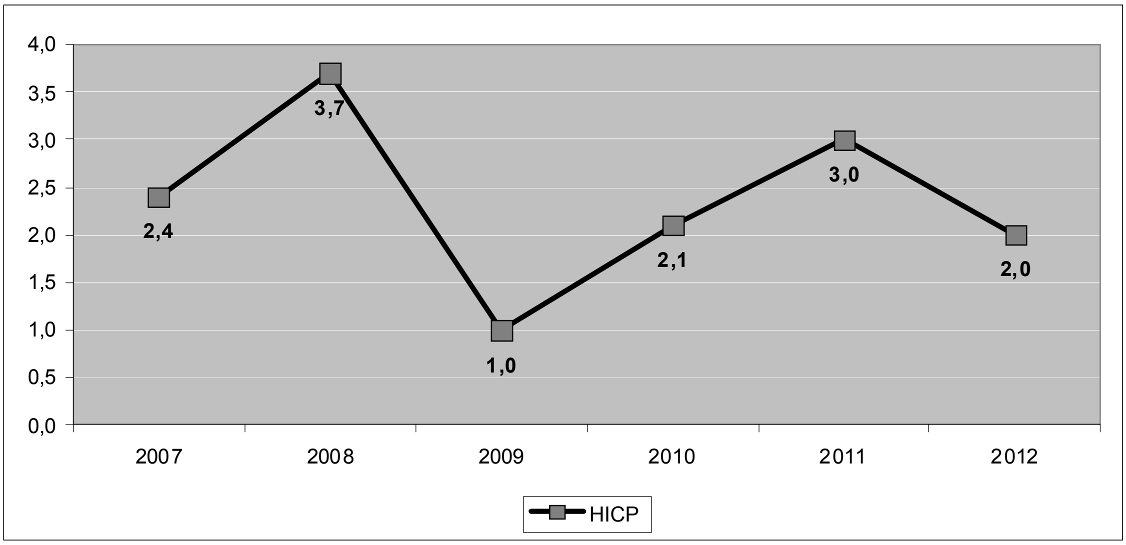
[10] Source: *European Economic forecast — spring 2011*, DG ECFIN.

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



Source: Eurostat (2007-2010) and DG ECFIN (2011-2012)

In this context, no inflationary spiral scenario is expected to occur in the near future. Nevertheless, fears of disruptions to oil supply from developments in the Middle East and Northern Africa are putting pressure on commodity prices.

Second-round effects from commodity price increases on inflation would occur if price setters and wage earners are unwilling to absorb the full cost increase. As price setters pass on some of the cost to production costs and as wage earners demand higher salaries (to compensate for a larger energy bill), a wage-price spiral could begin. In this way the initial shock in the commodity prices would be perpetuated. Moreover, this mechanism would lead to a simultaneous increase in inflation expectations, influencing both the pricing strategy of companies and wage negotiations.

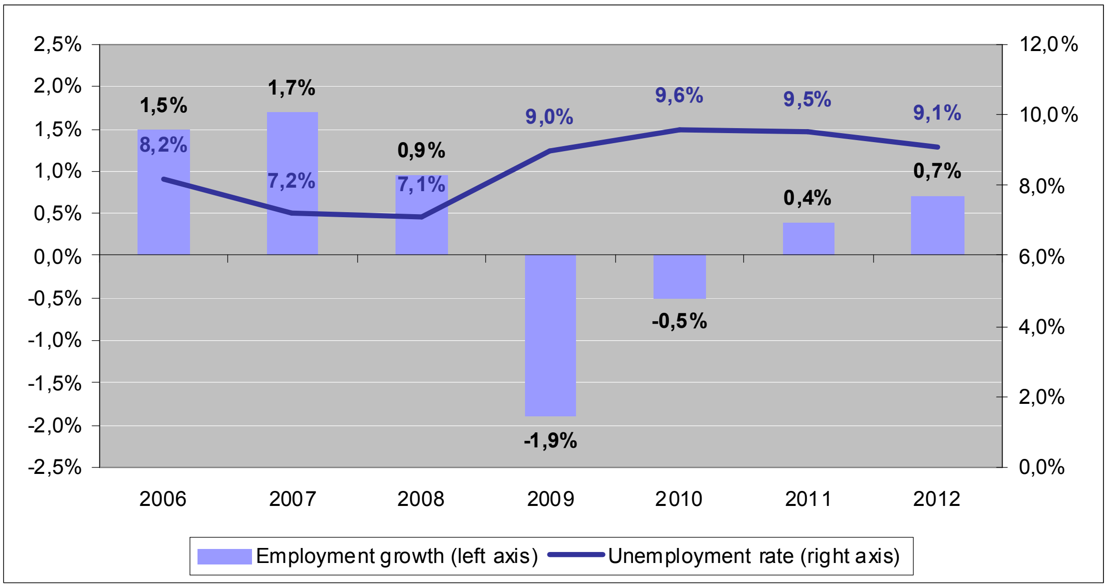
However, at the current juncture we observe no signs of second-round effects in the European economy and the European Central Bank, which is monitoring the situation, is ready to tighten monetary policy in an effort to keep inflation close to target. Indeed, at the moment inflation expectations are close to the target, and wage settlements and price setting outside the food and energy markets are not a matter of concern. No sign of excessive wage claims is present in the most recent wage negotiations within the EU.

The probability of the resurgence of second-round effects in the coming months may not be very high. The situation the EU economy is facing in the near future is very different from that prevailing at the time of the oil shocks in the 1970s, when it took only a year for the original shock to energy prices to spill over to core inflation. Monetary policy is now more credible, wage earners face greater flexibility in the labour market, and sellers of goods and services face more competition. The existing slack in the European economy will also help in keeping inflation under control.

5.2.4. *The labour-market situation has started to stabilise*

Job shedding came to an end in the second quarter of 2010. After a peak at 9.6%, the unemployment rate within the EU is projected to slightly decrease in 2011, to 9.5%, and more significantly in 2012, reaching 9.1% (see Figure 8).

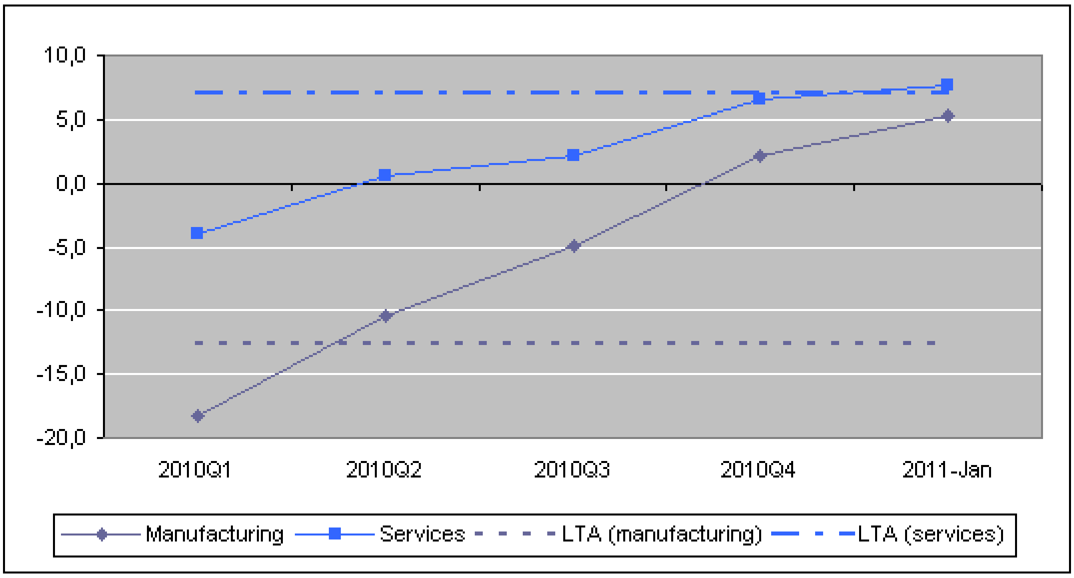
Figure 8: Employment growth and unemployment rate within the EU-27 (2006 – 2012)



Source : Eurostat (2006-2010) and DG ECFIN (2011-2012)

More particularly, the euro-area labour market appeared surprisingly resilient through the recession in comparison with historical experience, notably as policy measures taken during the crisis succeeded in keeping older and female workers in employment. Employment expectations have followed an upward trend since the beginning of 2010, especially in the manufacturing sector but also in services, where the long-term average (LTA) is about to be overtaken (see Figure 9).

Figure 9: Employment expectations within the euro-area in 2010 – 2011 (balance)



Source: DG ECFIN

However, we can observe considerable differences in unemployment responses across countries, due to different situations and structures of national labour markets. Some countries have been particularly impacted, with unemployment rates exceeding 10% in nine Member States.

5.2.5. Compensation in the public sector versus the total economy

The Commission also 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[11], both in the public sector (general government sector[12]) and in the total economy. It should be noted that data on the total economy include those for the public sector. The weight of the public sector in the total economy is of the order of 22%.

We can generally observe that compensation in the private sector is highly correlated to economic cycles: compensation of employees in the total economy increased by 5.3% in 2007 and 4.3% in 2008 but dropped by 0.2% in 2009 at the heart of the financial turmoil, while GDP fell by 4.2% (see Figure 11).

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

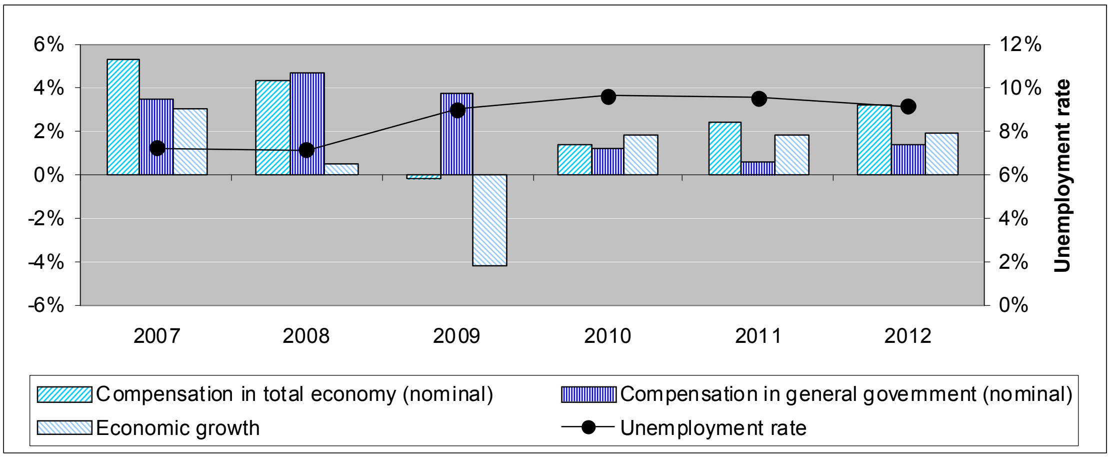
12 The public sector stands for general government throughout this section. The general government sector includes all institutional units which are other non-market producers whose output is intended for individual and collective consumption, and mainly financed by compulsory payments made by units 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.

Nonetheless, although compensation in the public service may not necessarily follow economic cycles, the annual increase in compensation of employees in the public sector fell from 3.7% to 1.2% in 2010. According to DG ECFIN forecasts, this trend is expected to continue in 2011 (0.6%) and 2012 (1.3%), while compensation in the total economy is likely to increase by 2.4% in 2011 and 3.2% in 2012 (see Figure 10).

Furthermore, while the economic recovery started in 2010, cumulative changes in compensation in the total economy from 2004 onwards are already about to overtake cumulative changes in compensation in the public sector over the same period (see Figure 11): from 2004 to 2010, compensation in the EU increased in nominal terms by 28% in the public sector compared to 25% in the private sector, mainly due to the downturn in economic activity. According to DG ECFIN forecasts, it is likely to rise to 31% by 2012 (starting from 2004) in the public sector against 32% in the private sector.

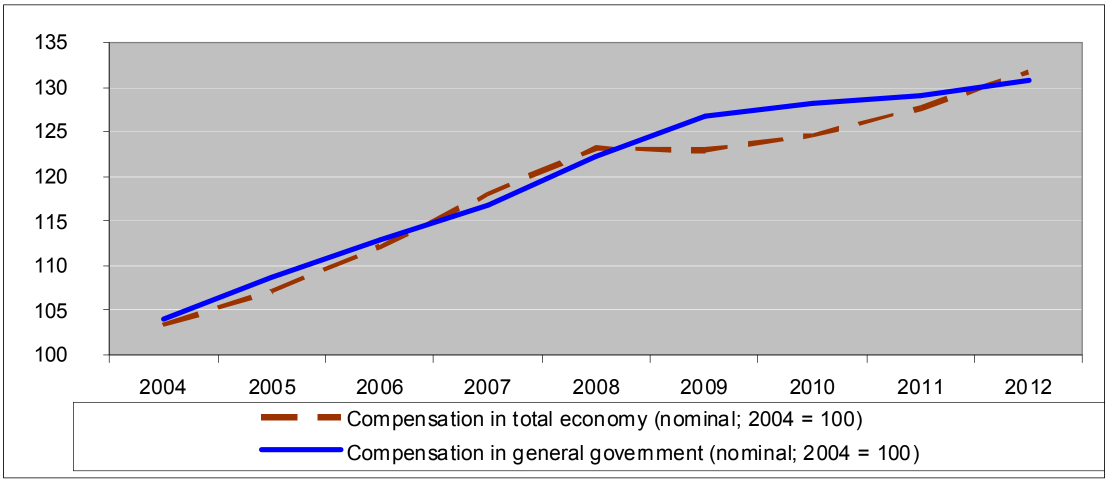
Altogether, the impact of the crisis in the public sector was delayed and was less far-reaching than in the private sector. However, the consequences of the crisis will continue to be felt for a long time by civil servants, both in the Member States and in the EU institutions, because of the need to make significant fiscal retrenchments in the coming years.

Figure 10: Changes in compensation of employees within the EU-27, total economy versus general government (2007 – 2012)



Source: Eurostat (2007-2010) and DG ECFIN (2011-2012)

Figure 11: Cumulative changes in compensation of employees in the EU, total economy versus general government (2004 – 2012)



Source: Eurostat (2004-2010) and DG ECFIN (2011-2012)

Table 11: Changes in compensation of employees in the EU (annual % change)

	2004	2005	2006	2007	2008	2009	2010	2011*	2012*
General government	4,1	4,3	3,9	3,4	4,6	3,7	1,2	0,6	1,3
Total economy	3,4	3,7	4,6	5,3	4,3	- 0,2	1,3	2,4	3,2

Source: Eurostat (2004-2010) and DG ECFIN (2011-2012)

6. CONCLUSION

The exception clause is not to be applied during every downturn in economic activity. The legislator carefully chose the economic and social criteria to be taken into account for salary and pension adjustments; these criteria can be applied during both an upswing and a downturn in the economy. The method can be applied equally when salaries in Member States increase or decrease, and the gain or loss in the purchasing power of national civil servants will be directly reflected in the salaries and pensions of EU civil servants. Hence, the exception clause is to be used when there are extreme developments in the EU and only if the method is not able to measure them. It is not to be used whenever the EU is in the downward phase of an economic cycle.

It follows from the foregoing considerations and analysis that there has 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. Moreover, no event has been identified that has not been or could not be captured by the method. Therefore, the Commission considers that it is not appropriate to submit a proposal under Article 10 of Annex XI to the Staff Regulations.

However, on 29 June 2011, the Commission took note of a draft proposal for a new method, including possible amendments to the mechanism of the exception clause, in order to render its application automatic under specific conditions in the future.