Besides expenditure-cutting measures, the expected decline in primary expenditure also partly reflects the fading of financial sector support in a number of countries. The euro area general government debt ratio is projected to peak at around 96% of GDP in 2014 and to decline thereafter for the first time since the outbreak of the financial crisis, mainly as a result of the debt-reducing impact of a gradual rise in primary surpluses.

BUDGETARY DEVELOPMENTS AND PLANS IN SELECTED COUNTRIES

In the course of 2013, several euro area countries have further improved their fiscal positions compared with 2012, in line with the European Commission's autumn 2013 economic forecast. However, cross-country differences continue to be substantial. While some countries are projected to have exceeded their fiscal targets in 2013, others are expected to show consolidation gaps and are at risk of not meeting the EDP deadlines. In the context of the 2014 draft budgetary plans, which is a newly created monitoring exercise for the 13 non-programme euro area countries as part of the "two-pack" regulations, the Commission has identified risks of non-compliance with the Stability and Growth Pact (SGP) for several countries (see Box 7).

Box 7

FISCAL CONSOLIDATION IN THE EURO AREA: PAST PROGRESS AND PLANS FOR 2014

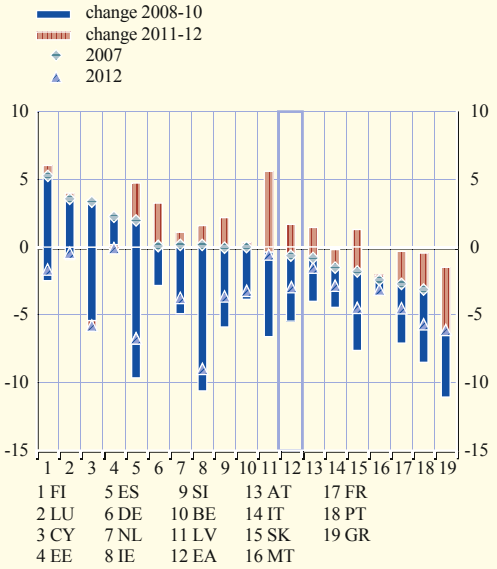
This box takes stock of the progress made in fiscal consolidation in the euro area and the further needs for consolidation. The financial crisis has resulted in a very strong deterioration in government deficit and debt ratios in euro area countries. The consolidation strategy adopted in 2010 is now starting to bear fruit, with the euro area government deficit having more than halved from its peak level and the aggregate euro area debt ratio expected to stabilise in 2014. This improvement, however, masks important heterogeneity across euro area countries. Many countries still have a long way to go before reaching sound fiscal positions. In line with the "two-pack" regulations, in October 2013, Member States submitted their draft budgetary plans to the European Commission for the first time. In its assessment, the Commission found only two draft budgetary plans (Germany and Estonia) to be in full compliance with EU fiscal rules. Five draft budgetary plans (Spain, Italy, Luxembourg, Malta and Finland) were found to be at risk of non-compliance with the rules in the absence of additional measures. On 22 November 2013, the Eurogroup endorsed the Commission's assessment and invited Member States to take the Commission's concerns into account before finalising their 2014 budgets. Looking ahead, it is essential that fiscal consolidation efforts continue to ensure a return to sound fiscal positions as soon as possible.

The legacy of the crisis

The financial crisis that took hold in mid-2008, and the contraction in economic activity that followed, led to a very strong deterioration in the fiscal position of the euro area and its member countries. Since the end of 2008, emergency measures have been implemented in the majority of euro area countries to provide financial support to banks in difficulty and to preserve euro area-wide financial stability. At the same time, and in order to limit the negative fallout of the crisis on economic activity, a coordinated budgetary stimulus was adopted in the context of the European Economic Recovery Plan (EERP). The EERP called for Member States to adopt, consistent with their room for fiscal manoeuvre, temporary and targeted fiscal stimulus measures in the course of 2009-10.

Chart A Developments in the deficit-to-GDP ratios (2007-13)

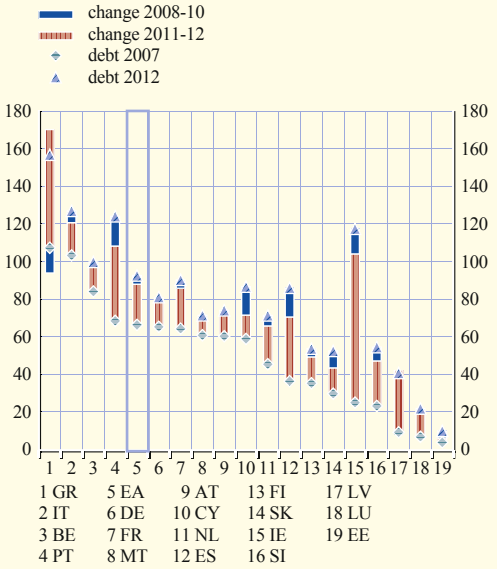
(as a percentage of GDP; percentage points)



Sources: AMECO data and ECB calculations.
Notes: Data are net of the budgetary impact of financial support to the banking sector, as reported by Eurostat. The countries are ranked according to the budget balance in 2007.

Chart B Developments in the debt-to-GDP ratios (2007-13)

(as a percentage of GDP; percentage points)



Sources: AMECO data and ECB calculations.
Note: The countries are ranked according to the debt-to-GDP ratio in 2007.

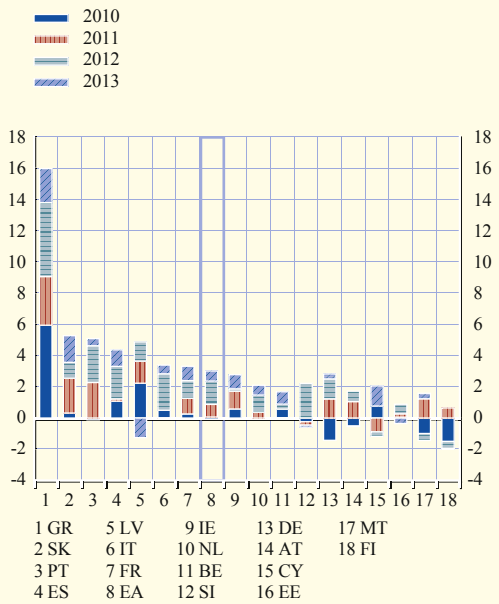
These policy actions, combined with the working of automatic stabilisers, caused budget deficits and debt-to-GDP ratios across the euro area to rise to unprecedented levels, well above the reference criteria laid down in the Stability and Growth Pact (SGP) (see Charts A and B). As a result, by end-2009, an excessive deficit procedure (EDP) had been launched in 13 euro area countries. Over the period 2008-09, the euro area aggregate nominal budget balance deteriorated by 5.7 percentage points of GDP, while the structural budget balance deteriorated by 2.5 percentage points of GDP.

Progress in fiscal consolidation over the period 2010-13

In October 2009, the ECOFIN Council agreed on the principles for a coordinated exit from the fiscal stimulus adopted earlier. It was agreed that the specificities of country circumstances should be taken into account when defining the pace of adjustment, but that fiscal consolidation in all euro area countries should start by 2011 at the latest; countries with sustainability concerns would need to start consolidating earlier. It was recommended that the planned pace of fiscal consolidation be ambitious and well beyond the benchmark of 0.5% of GDP per annum in structural terms in most Member States. Following these principles and the provisions of the SGP, which, under special circumstances, allow for the correction of excessive deficits in a medium-term framework rather than in the year following their identification, the EDP recommendations, issued in the course of 2009, granted relatively long deadlines for the correction of the excessive deficit, ranging initially from two to four years. The annual average structural effort required to correct the fiscal imbalances ranged from above 0.5 percentage point of GDP to more than 2 percentage points of GDP for countries with significant sustainability concerns.

Chart C Change in the structural budget balance (2010-13)

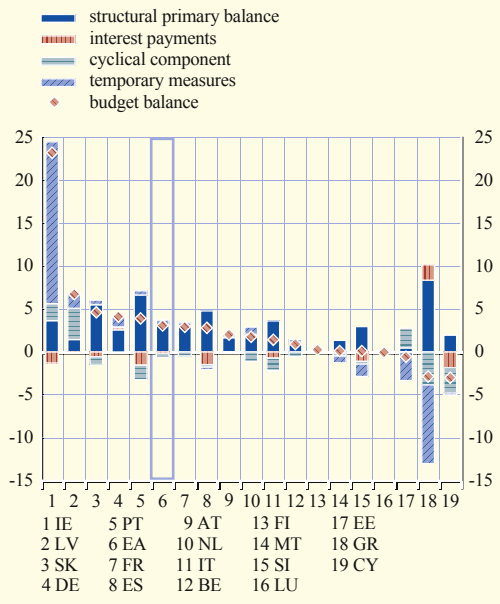
(percentage points of GDP)



Sources: Ameco data and the European Commission's autumn 2013 economic forecast.
Note: The countries are ranked on the basis of the cumulative change in the structural budget balance.

Chart D Decomposition of changes in budget balance (2011-13)

(percentage points of GDP)



Sources: AMECO data, the European Commission's autumn 2013 economic forecast and ECB calculations.
Note: Data include the effect of financial support to the banking sector.

In 2010, the euro area sovereign debt crisis exposed weaknesses in the EU economic governance framework. In response, the so-called "six-pack" regulations were introduced in December 2011. In addition, several countries notably stepped up their consolidation efforts in an attempt to regain financial market confidence. This marked the beginning of a period of protracted fiscal consolidation, especially for countries under a joint EU/IMF financial assistance programme and those experiencing significant tensions in financial markets. As a result, in several countries consolidation efforts (measured by the change in the structural budget balance) turned out to be much larger than assumed when the 2009 EDP recommendations were issued (see Chart C).

Over the period 2010-13, the consolidation efforts succeeded in reversing the trend of rising budget deficits in most countries. As a consequence, the euro area budget deficit has been gradually declining from its peak of 6.4% of GDP in 2009 and is expected to reach 3.1% of GDP this year. However, budget deficits remain above the pre-crisis values in many countries. Indeed, headline budget balances improved by less than initially envisaged, owing to: (i) adverse cyclical developments and one-off factors related to the budgetary impact of the financial support to the banking sector (see Chart D) and; (ii) in some cases, less ambitious consolidation efforts than initially planned. As a consequence, many countries missed their EDP deadlines and deadline extensions were granted in the course of 2012 and 2013, in some cases by two years, i.e. beyond the one-year horizon which should apply, as a rule, under the SGP. Likewise, debt-to-GDP ratios remained well above the pre-crisis levels and continued to rise, owing predominantly to a large

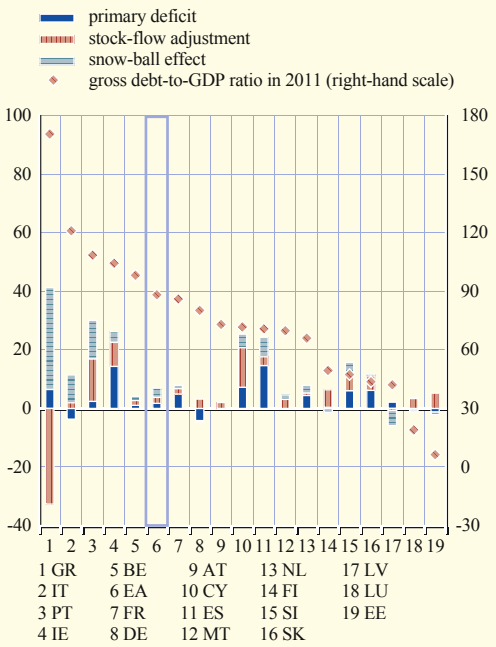
positive differential between the interest rate on outstanding debt and the growth rate of the economy as well as financial support granted to the banking sector (see Chart E).[1]

Budgetary plans for 2014

According to the European Commission's autumn 2013 economic forecast, in 2014 the euro area budget deficit is projected to fall below the reference value (2.5% of GDP). This continued reduction in budgetary imbalances is broadly consistent with the 2014 draft budgetary plans, which euro area countries that are not subject to a financial assistance programme submitted for the first time in October 2013 under the new "two-pack" regulations. Most of the 13 euro area countries that submitted these plans expect to reduce their budget deficits further in 2014. However, when compared with budgetary plans for 2014, as outlined in the 2013 stability programmes of spring this year, the vast majority of governments expect either broadly unchanged or worse than initially foreseen fiscal positions. At the same time, as indicated by the European Commission's autumn 2013 economic forecast, the structural effort in 2014 is expected to fall short of commitments under the SGP in many countries (see the table). As a result, for the countries participating in this surveillance exercise, the structural effort is projected to amount to about ¼% of GDP in 2014, which is significantly lower than the structural adjustment benchmark of 0.5% of GDP under the SGP. On the one hand, this lower structural effort pertains to a lack of progress towards countries' medium-term budgetary objectives under the preventive arm of the SGP. On the other, it relates to insufficient structural efforts under its corrective arm, the EDP. In this respect, it should be noted that the required structural efforts were already lowered markedly in June 2013, when several countries' EDP recommendations were revised to grant deadline extensions.

Chart E Decomposition of changes in debt-to-GDP ratios (2011-13)

(as a percentage of GDP; percentage points)



Sources: AMECO data, the European Commission's autumn 2013 economic forecast and ECB calculations.

The European Commission's opinions on the draft budgetary plans, which were released on 15 November, indeed highlight the fact that structural efforts are, in the absence of additional measures, at risk of falling short of commitments under the SGP in 2014 in many euro area countries. While the Commission did not identify any cases for which a draft budgetary plan was particularly seriously non-compliant with the rules of the SGP – which would have allowed it to request a revised plan according to Regulation (EC) No 473/2013 – it has assessed that only Germany's and Estonia's budgetary plans are fully compliant with the SGP's rules. At the same time, it finds that

1 The financial support provided to banks in difficulty contributed to the deterioration in the fiscal positions of many countries, including Ireland, where the deficit-increasing effect of such support amounted to about 20 percentage points of GDP in 2010. Part of this support has now been recovered through the payment of fees/interest. For a comprehensive overview of the budgetary impact of financial sector support since 2008, see the box entitled "The fiscal implications of financial sector support", *Monthly Bulletin*, ECB, June 2013.

2014 draft budgetary plans

Commission opinion on compliance of 2014 draft budgetary plans with the SGP	Budget balance (as a percentage of GDP)		General government debt (as a percentage of GDP)		Actual structural effort (European Commission's autumn 2013 economic forecast)	Structural effort commitment under SGP (in percentage points)
	2013 stability programme	2014 draft budgetary plan	2013 stability programme	2014 draft budgetary plan		
"Compliant"						
Germany *(preventive arm)*	0.0	0.0	77.5	77.0	0.0	*0.0 (at MTO)*
Estonia *(preventive arm)*	0.0	-0.4	9.9	10.0	0.5	*0.5 benchmark*
"Compliant but without any margin for possible slippage"						
France *(2015 EDP deadline)*	-2.9	-3.6	94.3	95.1	0.7	*0.8*
Netherlands *(2014 EDP deadline)*	-3.0	-3.3	75.0	76.1	0.4	*0.7*
Slovenia *(2015 EDP deadline)*	-2.6	-6.7	63.2	65.5	0.7	*0.5*
"Broadly compliant"						
Belgium *(2013 EDP deadline)*	-2.0	-2.1	99.0	100.2	0.4	*0.5 (debt benchmark)*
Austria *(2013 EDP deadline)*	-1.5	-1.5	73.0	74.0	0.1	*0.5 benchmark*
Slovakia *(2013 EDP deadline)*	-2.6	-2.8	56.3	54.1	-0.8	*0.5 benchmark*
"Risk of non-compliance"						
Spain *(2016 EDP deadline)*	-5.5	-5.8	96.2	98.9	-0.1	*0.8*
Italy *(Transition period: debt benchmark)*	-1.8	-2.5	129.0	132.7	0.1	*0.7 (debt benchmark)*
Luxembourg *(preventive arm)*	-0.6	-	25.9	-	-0.6	*0.5 benchmark*
Malta *(EDP deadline 2014)*	-2.1	-2.1	74.2	73.2	-0.1	*0.7*
Finland *(preventive arm)*	-1.3	-1.9	57.3	60.7	-0.2	*0.5 benchmark*

Sources: European Commission, Eurostat, 2013 stability programmes and 2014 draft budgetary plans.
Notes: The countries mentioned in the table include euro area countries that are not subject to a financial assistance programme. They are ordered according to the grouping used in the European Commission's opinions to assess compliance of the 2014 draft budgetary plans with the SGP's rules. The structural effort commitment relates to the benchmark of 0.5% of GDP for countries under the preventive arm of the SGP; for countries under the corrective arm, it relates to the structural effort commitments as outlined in the Council recommendations. Italy's structural efforts need to be compliant with the debt benchmark in the transitional period; the same would apply to Belgium and Austria in the event of a timely abrogation of the EDP. Luxembourg did not submit a detailed draft budgetary plan for 2014.

the draft budgetary plans for five countries pose risks of non-compliance with the rules of the SGP under the preventive arm (Italy, Luxembourg and Finland) and the corrective arm (Spain and Malta) (see the table for an overview).[2] On 22 November, the Eurogroup concurred with the Commission's opinions and analysis and agreed to take the Commission's concerns into account in countries' budgetary processes.[3] The Eurogroup invited those Member States whose plans were at risk of non-compliance with the SGP "to take measures as appropriate within their national budgetary processes or in parallel to that, to address the risks identified by the Commission and to ensure full compliance of the 2014 budget with the SGP rules". In order to be fully effective in fostering sound budgetary positions, it is, therefore, essential that this new surveillance exercise be followed up in a structured manner. In this respect, it should be noted that the "two-pack" regulations assign new powers to the Commission, in particular the possibility to issue an autonomous recommendation, in line with Article 11(2) of the "two-pack" Regulation (EC) No 473/2013, in cases of a risk of non-compliance with the deadline to correct the excessive deficit.

Overall, fiscal developments since the onset of the crisis have been rather heterogeneous across countries, reflecting the initial situation of public finances, the existence of macroeconomic imbalances, the solidity of the domestic financial sector and different degrees of resilience of the

2 In the case of Luxembourg, this relates notably to the absence of a detailed budgetary plan, as a new government had not been formed at the time the plan was submitted.
3 See the Eurogroup Statement of 22 November 2013 at http://www.eurozone.europa.eu/newsroom/news/2013/11/eurogroup-statement

domestic economy to external shocks. Looking ahead, the reduction of very high debt-to-GDP ratios, which weigh on economic growth, remains imperative.[4] This requires ambitious medium-term budgetary plans that combine the reduction of excessive fiscal imbalances with ambitious structural reforms.

4 See the box entitled "Growth effects of high government debt", *Monthly Bulletin*, ECB, March 2013.

In November 2013, the European Commission also assessed whether the six euro area countries for which the EDP deadlines were recently revised (i.e. Belgium, Spain, France, Malta, the Netherlands and Slovenia) had taken effective action to correct the excessive deficits by the agreed deadline. Based on a three-staged process for assessing effective action – i.e. nominal headline targets, corrected/uncorrected improvement of the structural balance, bottom-up approach – the European Commission determined that all countries had indeed taken effective action in 2013 to end the excessive deficit within the recommended deadline. However, based on the European Commission's autumn 2013 economic forecast, several countries are expected to miss their nominal targets by the recommended deadline if additional consolidation measures are not adopted.

A brief review of recent budgetary developments and the budgetary plans to meet the fiscal targets in the largest euro area countries and the EU/IMF programme countries is provided below.

Germany is expected to have reached a balanced budget in 2013. In the recent review of draft budgetary plans by the European Commission, Germany is expected to fully comply with the requirements of the SGP in both 2013 and 2014. However, as the budget for 2014 is currently based on a no-policy-change scenario, the fiscal outlook will have to be reassessed once the new government has taken office and submitted an updated budgetary plan.

In France, the general government deficit for 2013 is expected to reach 4.1% of GDP, 0.4 percentage point higher than the target set out in the April 2013 stability programme update and 0.2 percentage point higher than the target under the revised EDP recommendation issued in June. Moreover, the structural improvement falls short when compared with the requirements (0.9% of GDP instead of 1.3% of GDP). Nevertheless, the European Commission considers that France has taken effective action because, in its view, the shortfalls can be explained by unexpected revenue shortfalls. However, the Commission assessment also notes that the yield of discretionary revenue measures may have been overestimated and that it would reassess the situation on the basis of final 2013 outcomes. The draft budgetary plan for 2014 is aimed at meeting the EDP deficit target of 3.6% of GDP. The expenditure-based measures in the budget law are intended to create savings of around 0.7% of GDP. The savings would stem from public wage moderation, a reduction in investment, postponement of pension indexation, the family branch reform and a reduction in health expenditure. Nevertheless, the nominal target for 2014 is expected to be missed according to the European Commission's forecasts (-3.8% of GDP instead of -3.6%). Fiscal slippages in 2014 would put the 2015 deadline for correcting the excessive deficit and the reversal of the upward trend in the government debt-to-GDP ratio, which will exceed 93% in 2013, at risk.

In Italy, the 2013 deficit-to-GDP ratio is expected to stand at 3%, against the 2.9% target set in the 2013 stability programme update. The deviation is mainly on account of a worsening of macroeconomic conditions, although additional consolidation measures amounting to 0.1% of GDP were adopted in October 2013 to ensure that the deficit ratio does not exceed the 3% of GDP reference value. The draft budgetary plan for 2014 foresees a deficit-to-GDP ratio for 2014 of 2.5%