5 Review of draft budgetary plans for 2017 and the budgetary situation for the euro area as a whole

On 16 November the European Commission released its opinions on euro area governments' draft budgetary plans for 2017,[30] together with an analysis of the budgetary situation for the euro area as a whole. The opinions on the draft budgetary plans include an assessment of the plans' compliance with the Stability and Growth Pact (SGP). They also follow up on the guidance provided in the country-specific recommendations for fiscal policies under the 2016 European Semester, as adopted by the Economic and Financial Affairs Council on 12 July 2016.[31] Jointly with these opinions, the Commission released a communication entitled "Towards a positive fiscal stance for the euro area", in which it discussed the current role of fiscal policies in the euro area at the aggregate level. This reflects the mandate in Regulation (EU) No 473/2013 (part of the "Two-Pack"), which calls on the Commission to "make an overall assessment of the budgetary situation and prospects in the euro area as a whole, on the basis of the national budgetary prospects and their interaction across the area".

The Commission's assessment, based on its 2016 autumn economic forecast, is that only five of the 18 draft budgetary plans are fully compliant with the SGP. The Commission finds the plans of Germany, Estonia, Luxembourg, the Netherlands and Slovakia (all under the preventive arm) to be "compliant" with the SGP, unchanged from the previous year, while it regards the draft budgetary plans of five countries as only "broadly compliant" (see the table).[32] Under the SGP's preventive arm this relates to Ireland, Latvia, Malta and Austria. Under the corrective arm – the excessive deficit procedure (EDP) – it affects France. While France's headline deficit is forecast to fall below the deficit reference value of 3% of GDP by the 2017 EDP deadline, the correction of the excessive deficit is not expected to be sustainable in the light of sizeable cumulated shortfalls in structural efforts vis-à-vis commitments under the SGP.[33]

30 The draft budgetary plans exclude those of euro area countries under a financial assistance programme, i.e. Greece.

31 See the box entitled "Country-specific recommendations for fiscal policies under the 2016 European Semester", *Economic Bulletin*, Issue 4, ECB, June 2016.

32 For details regarding the criteria underlying the assessment, see the notes accompanying the table.

33 According to the European Commission's 2016 autumn economic forecast, the structural effort is forecast at 0.6% of GDP cumulated over the period 2015-17, whereas 2.2% of GDP is recommended under the EDP recommendation that the Council issued to France in 2015.

Table

2017 draft budgetary plans

	Medium-term budgetary objective (MTO)	Structural balance in 2017 (Commission 2016 autumn forecast)	Actual structural effort 2017 (Commission 2016 autumn forecast)	2017 structural effort commitment under SGP (percentage points)
Compliance with the SGP				
Germany	-0.5	0.4	-0.2	at MTO
Estonia*	0.0	-0.2	-0.8	at MTO
Luxembourg	-0.5	0.4	-1.5	at MTO
Netherlands	-0.5	-0.2	0.3	at MTO
Slovakia	-0.5	-1.4	0.6	0.5
Broad compliance with the SGP				
Ireland[1]	-0.5	-1.0	0.7	0.6
Latvia* [1]	-1.0	-1.7	-0.2	-0.2
Malta[1]	0.0	-0.7	0.4	0.6
Austria* [1]	-0.5	-0.9	0.1	-0.1
France (EDP deadline 2017)[2]	-0.4	-2.3	0.2	0.9
Risk of non-compliance with the SGP				
Belgium[3]	0.0	-2.0	0.7	0.6
Italy[3]	0.0	-2.2	-0.5	0.6
Cyprus* [3]	0.0	-1.3	-1.4	-0.4
Lithuania* [3]	-1.0	-1.4	-0.4	-0.2
Slovenia[3]	0.25	-2.3	-0.2	0.6
Finland* [3]	-0.5	-1.6	-0.3	0.6
Portugal (EDP deadline 2016)[4]	0.25	-2.4	0.0	0.6
Spain (EDP deadline 2018)[4]	0.0	-3.8	0.0	0.5

Sources: European Commission and AMECO.
Notes: * Estonia, Cyprus, Latvia, Lithuania, Austria and Finland have applied for flexibility under the SGP (notably regarding structural reforms, investment and pensions).
1) For countries under the SGP's preventive arm, draft budgetary plans are "broadly compliant" if, according to the Commission's forecast, the plan may result in some deviation from the MTO or the adjustment path towards it, but the shortfall relative to the requirement would not represent a significant deviation from the required adjustment. Deviations from the fiscal targets under the preventive arm are classified as "significant" if they exceed 0.5% of GDP in one year or, on average, 0.25% of GDP in two consecutive years. At the same time, member countries are assessed as being in compliance with the debt reduction benchmark "where applicable".
2) For countries subject to an EDP, the Commission assesses draft budgetary plans as being "broadly compliant" if the Commission's forecast projects that the headline deficit targets will be achieved but there is a noticeable shortfall in fiscal effort compared with the recommended value, putting at risk compliance with the EDP recommendation.
3) Under the preventive arm, the Commission assesses draft budgetary plans as being "at risk of non-compliance with the SGP" if the Commission's forecast projects a significant deviation from the MTO or the required adjustment path towards the MTO in 2017, and/or non-compliance with the debt reduction benchmark "where applicable".
4) The Commission assesses countries under an EDP as being "at risk of non-compliance" if the Commission's forecast for 2017, subject to ex post confirmation, could lead to the stepping up of the EDP, as neither the recommended fiscal effort nor the recommended headline deficit target are forecast to be achieved.

Although some budgetary plans fall significantly short of SGP provisions, by the end of October the Commission had not called on any Member State to provide an updated plan, stating that the criterion of particularly serious non-compliance according to Regulation (EU) No 473/2013 was not fulfilled. Still, according to the Commission, the draft budgetary plans of eight countries pose a "risk of non-compliance" with the SGP. This compares with five countries in this category under last year's review exercise. Under the SGP's corrective arm, the group identified this year comprises Portugal and Spain,[34] with EDP deadlines in 2016 and 2018 respectively. Both countries are found to have taken effective action in 2016 in response to the notices to take additional measures issued under Article 126(9) of the Treaty on the Functioning of the European Union (TFEU) on 2 August. At the same time, significant shortfalls in structural efforts are forecast for 2017, although the Spanish authorities submitted a draft budgetary plan on a no-policy-change basis by the 15 October deadline and committed to submitting an updated and fully compliant plan at the Eurogroup meeting of 5 December.[35]

Under the preventive arm the group includes six Member States. For Belgium, Italy, Cyprus and Slovenia, the improvement in the structural balance towards the country-specific medium-term budgetary objective (MTO) is forecast to fall significantly short of requirements, i.e. by more than 0.5 percentage point of GDP. This assessment would hold even if they were granted, on an ex post basis, the flexibility under the SGP that some governments have applied for in their draft budgetary plans. The remaining two countries in the group are Lithuania and Finland, for which the shortfall in structural efforts towards the MTO would remain below the significance threshold even if the requested flexibility were to be granted ex post. The Commission will assess countries' eligibility for deviating from the adjustment path towards the MTO on the grounds of the SGP's flexibility provisions in spring 2017.

For Italy and Belgium, the Commission's opinions imply that compliance with the preventive arm ceases to apply as a mitigating factor when assessing their (non-)compliance with the debt rule. On 5 December the Eurogroup noted that "in light of prima facie non-compliance with the debt reduction benchmark, the Commission will issue a new report under 126(3) TFEU" for both countries. As regards Italy, the Commission had initially envisaged reviewing its assessment of relevant factors in November in a new report based on the draft budgetary plan for 2017.[36]

The draft budgetary plans point to a broadly neutral fiscal stance for the euro area in 2017, which strikes a balance between aggregate stabilisation and sustainability needs. Generally, the concept of the euro area aggregate fiscal stance provides a useful input to policy discussions and economic analysis at the euro area level, where a single monetary policy is complemented by national fiscal policies.[37] Nevertheless, it is not a legally binding constraint on Member States, which continue to be bound by the SGP. Taking note of the Commission's communication on an appropriate euro area fiscal stance, on 5 December the Eurogroup underlined "the importance to strike an appropriate balance between the

34 Spain and Lithuania, which submitted draft budgetary plans based on a no-policy-change scenario in the absence of a new government after general elections, have been requested to submit updated plans as soon as possible. Spain's Council of Ministers approved the updated draft budgetary plan for 2017 on 9 December. It foresees a headline deficit of 3.1% and a 0.5% improvement of the structural deficit ratio, in line with EDP commitments.

35 See http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/dbp/2016/assessement_pt_es_en.pdf.

36 For details see http://europa.eu/rapid/press-release_MEMO-16-1727_de.htm

37 For a discussion of the difficulties surrounding the assessment of the fiscal stance, see the article entitled "The euro area fiscal stance", *Economic Bulletin*, Issue 4, ECB, June 2016.

need to ensure sustainability and the need to support investment to strengthen the fragile recovery." The Eurogroup also recalled that, in July, euro area finance ministers had concluded that the broadly neutral fiscal stance in 2017 was striking an appropriate balance.

At the same time, the broadly neutral fiscal stance reflects a suboptimal composition across countries, as also observed by the Commission. On the one hand, a sizeable number of euro area countries need to step up their structural efforts to comply with the SGP. On the other hand, some countries are overachieving their MTOs and thus have scope to use fiscal space. In this respect, the Eurogroup statement recalls that "these Member States could use their favourable budgetary situation to further strengthen their domestic demand and growth potential [...], while respecting the MTO [...]."[38]

Looking ahead, an appropriate euro area fiscal instrument would be conducive to achieving fiscal policy goals at the euro area aggregate level. The Five Presidents' Report,[39] released in June 2015, recommends enriching the EMU institutional framework with a euro area fiscal instrument, e.g. to increase the automatic stabilisation capacity in the presence of large macroeconomic shocks. The report stresses that "the objective of automatic stabilisation at the euro area level would not be to actively fine-tune the economic cycle at euro area level. Instead, it should improve the cushioning of large macroeconomic shocks". In this context, the report emphasises that any move towards risk-sharing within the euro area "should be the culmination of a process that requires, as a precondition, a significant degree of economic convergence, financial integration and further coordination and pooling of decision-making on national budgets, with commensurate strengthening of democratic accountability".[40]

In the absence of such instruments and in view of the EU fiscal rules, the composition of national budgets remains the essential instrument for supporting economic activity. In this regard, the Commission finds that "the draft budgetary plans envisage only very limited changes in the composition of public finances in 2016-17 for the euro area as a whole". In this vein, the Eurogroup also acknowledged on 5 December that there was "scope for more growth-friendly choices" within government budgets, and reaffirmed the importance of reducing the burden of labour taxation as well as the benefits of well-designed reviews of government expenditure.

The Eurogroup will reassess countries' commitments in March 2017, based on the European Commission's 2017 winter forecast. It stressed in December 2016 that "fiscal policies should be pursued in full compliance with the SGP".

---

38 The SGP is, however, asymmetric in the sense that countries falling short of structural efforts vis-à-vis commitments need to ensure compliance, while countries with fiscal space are not required to use it.

39 See https://ec.europa.eu/priorities/sites/beta-political/files/5-presidents-report_en.pdf

40 At the same time, the European Fund for Strategic Investments (EFSI), which was set up in 2015, could potentially contribute to reducing regional disparities across the EU. According to a joint proposal from the Commission and the European Investment Bank, this is part of the EFSI's strategic orientation (see page 4 for details).