

Box 7

FOLLOW-UP TO THE REVIEW OF DRAFT BUDGETARY PLANS FOR 2015

This box summarises the follow-up to the review of draft budgetary plans for 2015, focusing on the seven countries whose 2015 draft budgets were identified by the European Commission in November 2014 as being at risk of non-compliance with the Stability and Growth Pact (SGP).¹ The countries concerned are Belgium, Italy, Malta and Austria under the Pact's preventive arm and France, Spain and Portugal under its corrective arm. At the Eurogroup meeting on 8 December 2014 the governments of these countries committed to adopt the measures that were needed to ensure compliance with the SGP. The Commission also announced that it would revisit its position regarding compliance with obligations under the SGP for Belgium, France and Italy, in early 2015, in the light of the finalisation of budget laws and the expected clarification of structural reform programmes announced by the countries' governments. Subsequently, on 13 January 2015, the Commission issued a communication entitled "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact", which clarified and partially extended the flexibility of the SGP as regards cyclical conditions, structural reforms and public investment.² On 25 February the Commission announced its decisions on Belgium, France and Italy and on 27 February it released its assessment, which was endorsed by the Council on 10 March, on the basis of the 2015 winter forecast.

With the exception of Belgium, none of the countries that were considered to be at risk of non-compliance with the SGP has implemented sufficient measures to allow the consolidation gap identified by the Eurogroup last December to be closed. Looking at countries under the corrective arm, France was asked to take additional measures amounting to 0.5% of GDP to bring the 2015 improvement in the structural balance in line with the effort required by the June 2013 recommendation under the excessive deficit procedure (EDP). However, the Commission's 2015 winter forecast points to no improvement on the 0.3% of GDP effort known at the time of the Eurogroup meeting.³ Meanwhile, in Spain and Portugal, which received recommendations to take steps to improve their headline deficits in order to comply with their 2015 EDP targets, projected deficits for 2015 have declined marginally but remain above target levels, while structural efforts are also falling short of requirements. As regards countries under the preventive arm, the 0.2 percentage point improvement in the structural balance that is expected in Italy in 2015 remains below the 0.4% of GDP that was recommended by the Eurogroup and is a reflection of reduced interest payments. By contrast, Belgium's structural effort is expected to increase by 0.2 percentage point, as committed to in the Eurogroup. In both Italy and Belgium, there continues to be significant deviation from the structural effort that is required under the debt rule. Austria's structural effort has declined compared with what was expected in December, further increasing the risks of a significant deviation from the requirements of the preventive arm, which, if confirmed ex post, could trigger procedural steps in spring 2016. Finally, in Malta, the risk of non-compliance with the requirements under

1 See also the box entitled "The review of draft budgetary plans for 2015", *Monthly Bulletin*, ECB, December 2014.

2 See also the box entitled "Flexibility within the Stability and Growth Pact", *Economic Bulletin*, Issue 1, ECB, February 2015.

3 The Commission assessed the original draft budgetary plan submitted on 15 October as implying an improvement in the structural balance of only 0.1% of GDP. On 21 November the government announced additional measures worth 0.2% of GDP. These measures, which were fully taken into account by the Eurogroup in its statement of 8 December, were approved by the French Parliament on 18 December 2014 in the context of the adoption of the 2015 budget.

the SGP's preventive arm, to which Malta will become subject if the Council decides that it corrected its excessive deficit by the deadline of 2014 and abrogates the corresponding EDP, has receded thanks to measures adopted in the final budget for 2015.

On 27 February the Commission released the results of its assessment regarding the implementation of the SGP in Belgium, France and Italy. In reports prepared under Article 126(3) of the Treaty on the Functioning of the European Union, the Commission examined the breach of the deficit criterion in Belgium and the breach of the debt criterion in Belgium and Italy. The Commission decided against opening an EDP for these countries on the basis of a number of relevant mitigating factors: in the cases of Belgium and Italy (i) the countries' compliance with the structural effort requirements under the preventive arm of the SGP (which in the case of Italy have now been reduced following the Commission's communication on flexibility within the SGP); (ii) the unfavourable economic conditions (i.e. weak growth and low inflation), which make compliance with the debt rule more difficult; and (iii) the expected implementation of the ambitious growth-enhancing structural reform plans presented by the authorities. Those assessments did not, however, take account of shortfalls in fiscal consolidation in the period 2014-15 relative to the Council's recommendations of June 2014 as an aggravating factor.

In the case of France, the Commission had to assess whether effective action had been taken in response to the Council's recommendation that the excessive deficit be corrected by 2015. Such action, combined with unexpected adverse macroeconomic events with major unfavourable consequences for government finances, would as a rule allow the deadline for correcting the excessive deficit to be extended by one year. In contrast, if a euro area country is assessed as not having taken effective action, the EDP foresees a stepping-up of the procedure by addressing a notice to the respective country⁴ and applying financial sanctions in the form of a fine of 0.2% of GDP. The Commission may, on the grounds of exceptional economic circumstances or following a reasoned request by the Member State concerned, recommend that the Council reduce the amount of the fine or cancel it. Looking at the period 2013-14⁵, the Commission reported that "the available evidence does not allow to conclude that no effective action was taken" and proposed extending the deadline for correction of the excessive deficit by two years (i.e. until 2017). The Council followed this recommendation on 10 March. The recommended adjustment path is back-loaded, requiring France to deliver rising structural adjustment efforts over the EDP period: 0.5% of GDP in 2015 (i.e. the level of the minimum requirement under the corrective arm and thus less than 0.8% of GDP required until now), 0.8% of GDP in 2016 and 0.9% in 2017. On the basis of current excessive deficit procedures, in 2017 France will be the only euro area country subject to an EDP. Finally, despite a risk of non-compliance with the deadlines recommended by the Council for the correction of their excessive deficits, the Commission did not address an early warning in the form of an autonomous recommendation to Spain or Portugal – in contrast to last year, when such recommendations were addressed to France and Slovenia in similar situations.

4 Under Article 126(9) of the Treaty on the Functioning of the European Union.

5 For this period, the assessment excludes the final year of the EDP period, for which the Commission identified risks of non-compliance with the SGP. It contrasts with the situation in 2013, when the EDP deadline was extended because effective action was only found to exist when the final year of the EDP period was included.

The EU's governance framework has been strengthened by the entry into force, in 2011 and 2013, of new regulations known as the "six-pack" and the "two-pack" respectively. Major improvements have thus been made to the framework as a result of the significant lessons learnt from the recent crisis. Of particular importance in this regard are the introduction of the debt rule in the corrective arm, the establishment of the significant deviation procedure in the preventive arm (which should help to ensure that countries make sufficient progress towards medium-term budgetary objectives), changes to the decision-making process to increase automaticity in the application of rules and sanctions, and the option to request revised draft budgetary plans and issue "autonomous recommendations" where EDP targets are at risk.

It is important that the tools in the strengthened governance framework are effectively applied in a manner which is consistent over time and across countries. It is key that they are indeed used as intended to ensure sustainable fiscal positions in euro area countries. Only this will allow the SGP to act as an anchor for confidence. To this end, the likelihood of applying the significant deviation procedure under the preventive arm has declined as adjustment requirements have been reduced over time for countries facing difficult macroeconomic environments. The excessive imbalance procedure has not yet been activated either, despite excessive imbalances being detected.⁶ Last but not least, the debt rule is at risk of being side-lined if it is de facto subordinated to the weakened preventive arm, which following the Commission's communication on flexibility pays little attention to debt sustainability concerns. In the end, full and consistent implementation is key for confidence in the European fiscal framework.

⁶ For more details, see the box entitled "The 2015 macroeconomic imbalance procedure", *Economic Bulletin*, Issue 2, ECB, March 2015.