Box 7

COUNTRY-SPECIFIC RECOMMENDATIONS FOR FISCAL POLICIES UNDER THE 2014 EUROPEAN SEMESTER

On 8 July 2014 the Economic and Financial Affairs Council adopted country-specific economic and fiscal policy recommendations for 26 non-programme countries in the European Union, i.e. all Member States except Cyprus and Greece, thereby formally concluding the 2014 European Semester.[1] The recommendations deliver opinions on the medium-term budgetary plans outlined in the stability and convergence programmes which countries had to submit to the European Commission by mid-April. To this end, the guidance for fiscal policies is designed to ensure that countries comply with the reinforced Stability and Growth Pact (SGP).[2] It has direct implications for the preparation and review of the draft budgetary plans for 2015 in November this year.[3] This is because Article 2a of Regulation 1466/1997 requires Member States to take account of the guidance addressed to them in the development of their budgetary policies before taking key decisions on their national budgets for the succeeding years.

Against this background, this box reviews the country-specific fiscal policy recommendations for the 16 euro area countries under the 2014 European Semester and highlights implications for the review of draft budgetary plans for 2015, which countries have to submit by mid-October.

Review of the country-specific recommendations for fiscal policies

According to the European Commission's spring forecast of 2014, the structural efforts made in the majority of euro area countries in 2014 will not be sufficient to fulfil their commitments under the SGP, with the risk of shortfalls rising in 2015 under a "no-policy-change" assumption (see Table A). In fact, the euro area's structural effort in 2014 is only expected to amount to about 0.15% of GDP and to turn negative in 2015 (-0.11% of GDP). This is significantly lower than the required structural adjustment stemming from countries' SGP commitments (0.5% of GDP on average in 2014). It also indicates an insufficient response to the opinions the European Commission had issued on draft budgetary plans for 2014 in November 2013, which deemed that only two countries (Germany and Estonia) had produced plans that were fully compliant with the SGP. Specifically, the Commission also asked eight euro area countries to come up with additional measures in order to comply with the commitments they had made under the SGP.[4]

Against this background, the country-specific recommendations for fiscal policies under the 2014 European Semester call on nine of the 16 euro area countries to reinforce their budgetary strategies in 2014. Specifically, these countries have been requested to take additional measures to address risks of non-compliance with the SGP (see Table A).[5]

1 These were based on proposals adopted by the European Commission on 2 June 2014, which were endorsed by the European Council on 26 and 27 June, thereby concluding the 2014 European Semester. For an overview of the 2014 European Semester, see the box entitled "Key challenges for the surveillance of economic and fiscal policies under the 2014 European Semester" in the March 2014 issue of the Monthly Bulletin.

2 For more information on the SGP reforms, see the box entitled "Stronger EU economic governance framework comes into force", *Monthly Bulletin*, ECB, December 2011, and the box entitled "The "two-pack" regulations to strengthen economic governance in the euro area", *Monthly Bulletin*, ECB, April 2013.

3 The review of the draft budgetary plans was introduced as a new element of fiscal surveillance in the euro area by the "two-pack" regulations, which entered into force on 30 May 2013.

4 For more information on the outcome of the first review under this exercise pertaining to draft budgetary plans for 2014, see the box entitled "Fiscal consolidation in the euro area: past progress and plans for 2014" in the December 2013 issue of the Monthly Bulletin.

5 This includes the two countries to which the European Commission had issued an autonomous recommendation in March this year, with France deemed to have broadly reacted to these recommendations and Slovenia partly.

Table A Country-specific recommendations for fiscal policies in 2014 and 2015

	Country	SGP commitment (change in the structural balance as a percentage of GDP – if not at MTO)		European Commission's 2014 spring forecast (change in the structural balance as a percentage of GDP)		Annual consolidation gap (difference between forecast and commitment – if not at MTO)		Country-specific recommendation for budgetary strategy	
		2014	2015	2014	2015	2014	2015	2014	2015
Preventive arm									
	Belgium	0.5	0.6	0	-0.2	-0.5	-0.8	reinforce	significantly strengthen
	Germany	at MTO	at MTO	-0.2	-0.4	at MTO	at MTO	ensure adherence to MTO	
	Estonia	0	0.5	-0.1	-0.2	-0.1	-0.7	reinforce	significantly strengthen
	Italy	0.7	0.7	0.1	0.1	-0.6	-0.6	reinforce	significantly strengthen
	Latvia	0	0.4	-0.5	-0.4	0.1**	-0.1**	preserve sound position	strengthen
	Luxembourg	at MTO	0	-0.8	-1.9	at MTO	-1.8	preserve sound position	significantly strengthen
	Netherlands	0.5	0.5	0	0.5	-0.5	0	reinforce	significantly strengthen
	Austria	0.6	0.6	-0.1	0.1	-0.7	-0.5	reinforce	significantly strengthen
	Slovakia	0.1	0.1	-0.2	0.4	-0.3	0.3	reinforce	ensure required adjustment
	Finland	0	0.1	-0.3	0.6	-0.3	0.5	limit gap to MTO	implement plan
Corrective arm (EDP)									
EDP deadline 2014	Malta	0.7	0.6	0.1	-0.1	-0.6	-0.7	correct EDP	significantly strengthen
EDP deadline 2015	Ireland*	1.9	1.9	1.7	0.4	n.a.	n.a.	fully implement	correct EDP
EDP deadline 2015	France	0.8	0.8	0.6	0.4	-0.2	-0.4	reinforce the budgetary strategy	
EDP deadline 2015	Portugal	1.4	0.5	n.a.	n.a.	n.a.	n.a.	implement necessary measures	implement revised strategy
EDP deadline 2015	Slovenia	0.5	0.5	0.2	0.2	-0.3	-0.3	reinforce [..] for 2014 and beyond	
EDP deadline 2016	Spain	0.8	0.8	0.4	-1.1	-0.4	-1.9	reinforce the budgetary strategy as of 2014	

Source: Country-specific recommendations for 2014 (http://www.consilium.europa.eu/special-reports/european-semester/documents-in-2014) and the European Commission's spring forecast.
Notes: The countries mentioned in the table include euro area countries that are not subject to a financial assistance programme (all Member States except for Cyprus and Greece). The structural effort commitment under the preventive arm of the SGP is based on a benchmark of 0.5% of GDP per year, but takes the debt ratio and the economic situation into account. Italy's structural efforts need to be compliant with the debt rule in the transition period. Under the SGP's corrective arm, the structural effort commitment relates to that outlined in the Council recommendations on correcting the excessive deficit.
* Ireland was subject to an EDP prior to the "six-pack" reform and thus required to deliver an average annual structural effort in the absence of annual targets.
** Accounting for pension reform costs.

In the same vein, for 2015, the recommendations call on euro area countries to include in their draft budgetary plans those measures necessary to ensure compliance with the SGP. For Germany, as the only euro area country that is expected to exceed the level required under the SGP in 2014 and 2015, the country-specific recommendations on fiscal policy include

preserving a sound fiscal position, ensuring that the medium-term budgetary objective is adhered to, while using the scope available for increased and more efficient public investment in infrastructure, education and research. They also include improving the conditions that further support domestic demand, inter alia by reducing high taxes and social security contributions, especially for low-wage earners.

For countries under the SGP's corrective arm, the recommendations address in particular the risks of structural efforts falling short of the annual and/or cumulated structural targets under the excessive deficit procedures (EDPs). For countries under the SGP's preventive arm, the recommendations notably address the risk of a significant deviation from the adjustment path towards the medium-term budgetary objective (MTO) of a structural balance that is close to balance or in surplus (e.g. Austria, Belgium, Estonia, the Netherlands and Slovakia), non-adherence to the expenditure benchmark (e.g. Austria, Belgium, Estonia, Italy, Luxemburg and Malta) and non-compliance with the debt rule, which requires that debt in excess of 60% of GDP is – after a transition period – reduced by one twentieth per year on average (e.g. Belgium and Italy). For the euro area as a whole, the consolidation gap with respect to the SGP requirements is expected to equal 0.6% in 2015.

The country-specific recommendations for 2014 for budgetary policies reflect the fact that an increasing number of euro area countries have become subject to fiscal surveillance under the SGP's preventive arm[6], or been advised to exit its corrective arm, the EDP, over the next few years. The cornerstorne of the preventive arm is the MTO of a structural balance close to balance or in surplus.[7] In order to comply with the requirements of the preventive arm, a country that has not achieved its MTO needs to improve its structural balance by 0.5% per year as a benchmark – with more effort required in good times and less in bad times.[8] The so-called six-pack regulations that entered into force in November 2011 strengthened fiscal surveillance under the preventive arm. Notably, they include the possibility of a financial sanction in the event of a significant deviation from the adjustment path towards the MTO. Additionally, the fiscal compact required the European Commission to present "calendars of convergence" to ensure that the Member States that deviate from the MTOs rapidly converge to them.[9] The MTO deadlines associated with these calendars of convergence were included in the country-specific recommendations for 2013. As indicated in Table B, several countries, including Austria, Belgium, France and Italy, are planning to reach their MTOs later than recommended by the Council in 2013, while Spain and Malta plan to reach theirs a year earlier. The Council's 2014 country-specific recommendations do not endorse the planned postponement for Austria, but keep the deadline for reaching its MTO unchanged at 2015. At the same time, this year's country-specific recommendations do not include updated guidance for countries which are expected to reach their MTOs after 2015.[10]

6 Among the 16 non-programme euro area countries participating in the European Semester, ten are currently subject to surveillance under the preventive arm. Malta has been advised to correct its EDP this year, Ireland, France, Portugal and Slovenia by 2015, and Spain by 2016.
7 The MTO is defined for each country on the basis of the state of public finances, the macroeconomic outlook and the expected costs associated with an ageing population.
8 Specifically, the adjustment requirement is set at 0.6% of GDP for countries with debt above 60% of GDP and in times that are neither good nor bad economically, which is indicated by an output gap between -1.5% and 1.5% of GDP. In times that are bad economically, countries that have an output gap between -1.5% of GDP and -4% of GDP and debt below 60% are required to improve their budget balance by 0.1% of GDP or more. Countries that have reached their MTO are not required to improve their structural balance any further.
9 See the article entitled "A fiscal compact for a stronger economic and monetary union" in the May 2012 issue of the Monthly Bulletin.
10 Such guidance would need to take into account revisions to the agreed method to estimate output gaps, which have led to an upward revision of the structural budget balance in some countries, notably Spain, and to a downward revision in Estonia (see "The revised methodology for calculating output gaps" in the European Commission's spring economic forecast for 2014).

Table B Medium-term budgetary objectives: government plans and Council recommendations

Country	Country-specific recommendation to reach MTO (issued in 2013)	Government plan to reach MTO as outlined in 2014 stability programme	Country-specific recommendation to reach MTO (issued in 2014)	MTO
Germany	- (assessed to be at MTO)	MTO maintained	maintain MTO	-0.5
Latvia	- (assessed to be at MTO)	MTO maintained	maintain MTO	-1
Estonia	- (assessed to be at MTO)	MTO maintained	2015*	>0
Finland	- (assessed to be at MTO)	2015	2015*	-0.5
Luxembourg	2013	2016	remain at MTO	0.5
Italy	2014	2016	2015	0
Netherlands	2015	2015	2015	-0.5
Austria	2015	2016	2015	-0.45
Belgium	2016	2017	-	0.75
France	2016	2017	-	0
Portugal	2017	2017	-	-0.5
Slovenia	2017	2017	-	0
Slovakia	2017	2017	-	-0.5
Spain	2018	2017	-	0
Ireland	2018	2018	-	0
Malta	2019	2018	-	0

Sources: Country-specific recommendations for 2013, available at http://www.consilium.europa.eu/special-reports/european-semester/documents-in-2013, and for 2014, available at http://www.consilium.europa.eu/special-reports/european-semester/documents-in-2014, as well as stability programmes for 2014, available at http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm.
Notes: The medium-term budgetary objectives (MTOs) reflect those stated in countries' stability programmes for 2014. Red numbers reflect a planned postponement of the MTO, and green numbers an early achievement. * Based on the Commission's recalculation of the structural balance contained in the stability programme, Finland and Estonia deviate from their MTO in 2014.

Overall, the country-specific recommendations on fiscal policies address risks of non-compliance with the SGP commitments in a comprehensive manner, thereby supporting the restoration of sound fiscal positions in the euro area. At the same time, fiscal surveillance under the strengthened governance framework will be most effective if the country-specific budgetary policy recommendations are fully consistent – over time and across countries – and sufficiently specific. This pertains to fully specifying consolidation gaps regarding SGP commitments, as well as issuing clearer guidance on the MTO deadlines, which would avoid them remaining "moving targets".[11]

Implications for the review of draft budgetary plans for 2015

Significant progress has been made towards restoring sound budgetary positions in euro area countries. This is indicated by the marked decline in nominal and structural government budget deficits across countries, as well as by the fact that an increasing number of countries have corrected their excessive deficits in recent years. On the market side, this has been reflected in the decline in sovereign yields that has been observed over the past two years. However, the European Commission's spring 2014 forecast highlights the risk of complacency, while further consolidation is needed over the medium term in order to reduce high debt ratios, in line with SGP commitments. It is therefore important that the reinforced fiscal governance framework is fully applied. The new review of draft budgetary plans, which was introduced by the "two-pack" and applied for the first time for 2014, can play a crucial role in this respect, as it can help to identify and address consolidation gaps at an early stage. The draft budgetary plans for 2015, which are scheduled to be submitted to the European Commission by mid-October, should therefore fully specify the measures needed to comply with the country-specific recommendations issued under the 2014 European Semester.

11 Such guidance should also clarify how the calendars of convergence should be updated, especially to take into account revisions in the starting positions which are partly linked to methodological changes.