Box 8
Country-specific recommendations for fiscal policies under the 2015 European Semester

On 25-26 June the European Council endorsed country-specific recommendations for economic and fiscal policies for 26 non-programme EU Member States.[1] These recommendations were adopted by the economic and finance ministers on 14 July to formally conclude the 2015 European Semester. The Council's fiscal policy recommendations aim to ensure that countries comply with the EU's Stability and Growth Pact (SGP). To this end, they give opinions on the 2015 updates to stability and convergence programmes, which governments had to submit to the Council and the European Commission by mid-April.[2] These opinions take account of the Commission's communication on flexibility within the SGP which was released in January this year.[3] In terms of follow-up work, the country-specific recommendations for fiscal policies issued under the 2015 European Semester will need to be reflected in the draft budgetary plans for 2016 which countries have to submit to the Eurogroup and the Council by mid-October. Against this background, this box reviews the recommendations for fiscal policies that were addressed to the 17 euro area countries under the 2015 European Semester and identifies the implications for their budgetary plans for 2016.

The European Council's country-specific recommendations identify risks of non-compliance with the structural effort requirements of the SGP in 12 of the 17 euro area countries under review. Overall, although the five euro area non-programme countries (Ireland, Portugal, Slovenia, Spain and France) currently subject to an excessive deficit procedure (EDP) are required to make, on average, structural efforts equivalent to 0.7% and 0.9% of GDP in 2015 and 2016 respectively in order to ensure compliance with the SGP, the average figures in a "no policy-change scenario" are actually expected to be slightly negative in both years.[4] In turn, the 12 euro area countries under the SGP's preventive arm are required to progress towards their medium-term budgetary objectives with structural efforts amounting to 0.2% of GDP on aggregate over 2015-16, yet the figures for this period are expected

[1] This includes all EU Member States except Cyprus and Greece.

[2] These programmes outline governments' budgetary plans for at least the current and subsequent three years. For an overview, see European Commission, "The 2015 stability and convergence programmes – an overview", *Institutional Paper*, No 2, July 2015, Brussels.

[3] On 13 January the European Commission issued a Communication entitled "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact" (http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/2015-01- 13_communication_sgp_flexibility_guidelines_en.pdf). See also the box entitled "Flexibility within the Stability and Growth Pact", *Economic Bulletin*, Issue 1, 2015.

[4] Under the SGP's corrective arm, the Council abrogated Malta's excessive deficit by the 2014 EDP deadline. At the same time, it decided against initiating an EDP for Finland, although the breach of the 3% of GDP reference value in 2014 is not forecast to be temporary, with the deficit not expected to return to below the reference value until 2016.

to be slightly negative.[5] The fiscal policy recommendations therefore call on eight Member States (Belgium, Estonia, Italy, Latvia, Lithuania, Malta, Austria and Finland) to make structural efforts commensurate with the preventive arm of the SGP. Two Member States (Belgium and Italy) also face large consolidation gaps with respect to the debt rule. The required improvement in the structural balance under the debt rule in 2015 is equivalent to 2.1% of GDP for Italy (resulting from cumulated consolidation shortfalls since 2013) – which compares with a forecast for structural efforts amounting to 0.3% of GDP – and 1.1% of GDP for Belgium (resulting from cumulated consolidation shortfalls since 2014) – which compares with a forecast for structural efforts amounting to 0.5% of GDP. These requirements are not reflected in the 2015 country-specific recommendations for Italy and Belgium, as the Commission has concluded that the deviation from the debt rule can be explained by relevant factors, such as unfavourable economic conditions and the implementation of structural reforms. In many countries, interest expenditure was lower than initially budgeted. At the same time, instead of using the savings from lower than expected interest payments to accelerate deficit adjustment, many Member States increased

Table

Country-specific fiscal developments in 2015 and 2016

		Country	SGP commitment (change in the structural balance; percentage of GDP – if not at MTO)		European Commission spring 2015 forecast (change in the structural balance; percentage of GDP)		Annual consolidation gap (difference between European Commission spring 2015 forecast and commitment – if not at MTO)		Memo: change in interest expenditure; percentage of GDP between 2014 and 2016 (European Commission spring 2015 forecast)
			2015	2016	2015	2016	2015	2016	2015-2016 (cumulated)
Preventive arm									
		Belgium	0.6	0.6	0.5	0.2	-0.1	-0.4	*-0.4*
		Germany	at MTO	at MTO	-0.2	-0.3	at MTO	at MTO	*-0.3*
		Estonia	-0.2	0.4	-0.5	-0.3	-0.4	-0.7	*0.0*
		Italy	0.25	0.1	0.3	-0.2	0.0	-0.3	*-0.4*
		Latvia	-0.4	0.3	-0.3	-0.3	0.1	-0.6	*-0.2*
		Lithuania	0.2	0.5	-0.7	0.7	-0.9	0.2	*-0.2*
		Luxembourg	at MTO	at MTO	-1.0	-0.2	at MTO	at MTO	*0.0*
		Malta	0.6	0.6	0.5	0.6	-0.1	0.0	*-0.3*
		Netherlands	at MTO	at MTO	-0.1	-0.1	at MTO	at MTO	*-0.1*
		Austria	-0.06	0.3	-0.4	-0.6	-0.3	-0.8	*-0.1*
		Slovakia	0.0	0.25	0.2	0.0	0.2	-0.2	*-0.4*
		Finland	0.1	0.5	-0.2	-0.4	-0.3	-0.9	*-0.1*
Corrective arm (EDP)									
	2015	Ireland*	1.9	0.6	0.5	0.3	-1.4	-0.3	*-0.6*
		Portugal*	0.5	0.6	-0.8	-0.6	-1.3	-1.2	*-0.4*
EDP deadline		Slovenia*	0.5	0.6	0.1	-0.5	-0.4	-1.1	*-0.3*
	2016	Spain	0.8	1.2	-0.4	-0.2	-1.2	-1.4	*-0.3*
	2017	France	0.5	0.8	0.3	0.0	-0.2	-0.8	*-0.1*

Sources: Country-specific recommendations for 2015 (http://www.consilium.europa.eu/en/press/press-releases/2015/06/19-country-specific-recommendations/) and the European Commission's 2015 spring forecast.
Notes: The countries mentioned in the table include euro area countries that are not subject to a financial assistance programme (i.e. all Member States except Cyprus and Greece). The structural effort commitments under the preventive and corrective arm of the SGP are as outlined in the 2015 country-specific recommendations. Ireland was subject to an EDP prior to the "six-pack reform" and is thus required to deliver an annual average structural effort in the absence of annual targets. * Structural effort requirements for 2016 as applicable under the preventive arm, assuming a timely abrogation of the EDP by the 2015 deadline. Structural effort requirements under the SGP's preventive arm exclude requirements under the debt rule. Figures are rounded up, except where they refer to SGP commitments.

[5] See also the box entitled "The effectiveness of the medium-term budgetary objective as an anchor of fiscal policies", *Economic Bulletin*, Issue 4, Frankfurt.

primary spending (i.e. government expenditure excluding interest payments) relative to their initial plans. Countries faced with high general government debt ratios (Belgium, France, Italy, Ireland and Portugal) are therefore advised to use any so-called windfall gains, i.e. savings from lower than anticipated interest payments, for deficit reductions. Moreover, of the countries that have already met their medium-term budgetary objectives, Germany has been advised to further increase public investment in infrastructure, education and research, while the Netherlands has been advised to shift public expenditure towards supporting investment in research and development.

The 2015 European Semester, which is the fifth surveillance cycle since its inception, followed a streamlined approach aimed at issuing fewer and more targeted recommendations. This reorganisation entailed, inter alia, earlier publication of European Commission analyses and recommendations in order to enhance dialogue with Member States. Overall, the 2015 country-specific recommendations appropriately reflect countries' risks of non-compliance with the EU's fiscal rules, while identifying the major areas for reform. To this end, they follow the broad fiscal policy guidance issued for this European Semester in the 2015 Annual Growth Survey, namely "[..] pursuing fiscal responsibility".[6] In general, the European Semester process can only be effective in increasing fiscal sustainability if non-compliance with the EU's fiscal rules is appropriately identified and addressed. In this context, the so-called five presidents' report published in June[7] proposes the establishment of a new European fiscal board, which would provide public and independent assessments of countries' budgetary policies vis-à-vis their obligations under the EU's fiscal framework. These would then feed into the decisions taken by the European Commission in the context of the European Semester. The report also proposes a more integrated European Semester, with national parliaments being involved more. Looking ahead, in the light of persistent vulnerabilities such as high government debt and sizeable structural deficits in euro area countries, any potential reforms of the European Semester should not weaken the ambition of recommendations for budgetary policies.

Fiscal policies should support the recovery, while remaining compliant with the Stability and Growth Pact. Full and consistent implementation is key for confidence in our fiscal framework. The draft budgetary plans for 2016 should therefore clarify how governments whose structural efforts fall short of their commitments under the SGP intend to follow up on the country-specific recommendations in order to ensure compliance with the EU's fiscal rules by reducing their deficits faster. With bond yields subject to volatility, the budgetary plans of high-debt countries in particular should allow for risks related to a reversal of the current low interest rate environment.

6 See European Commission, "Annual Growth Survey 2015", November 2014, Brussels (http://ec.europa.eu/europe2020/pdf/2015/ags2015_en.pdf).

7 See the report prepared by Jean-Claude Juncker, in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi and Martin Schulz, entitled "Completing Europe's Economic and Monetary Union", 2015, Brussels.