EUROPEAN
COMMISSION

Brussels, 15.11.2013
COM(2013) 900 final

COMMUNICATION FROM THE COMMISSION

2014 DRAFT BUDGETARY PLANS OF THE EURO AREA: OVERALL ASSESSMENT OF THE BUDGETARY SITUATION AND PROSPECTS

Executive summary

In response to the fiscal challenges of the crisis and under the reinforced economic governance, the Commission and the Member States are pursuing a differentiated fiscal strategy, according to the country-specific challenges. This autumn, for the first time, the euro area Member States presented draft budgetary plans to the Commission, seeking an opinion as to whether their budgetary plans for next year would be in line with their obligations under the Stability and Growth Pact (SGP).

By the deadline of 15 October, all euro area Member States not under a macroeconomic adjustment programme submitted their draft budgetary plans for 2014. The Commission has assessed them and provides Member States with an opinion on each plan. It is reassuring that no draft budgetary plan is found in serious non-compliance with the obligations of the SGP and it is not necessary to request revised budgetary plans. However, in several cases, the Commission finds reasons for substantial criticism and calls on the Member States concerned to take its opinions into account in the finalisation of the 2014 budgets.

The Commission comes to the following conclusions:

1. For two countries (Estonia and Germany), the draft budgetary plans are found to be compliant with the SGP provisions.
2. For three countries (France, the Netherlands and Slovenia) the draft budgetary plans are found to be compliant but without any margin for possible slippage, as this would put the correction of the excessive deficit at risk. The Commission invites the authorities to rigorously implement the budget.
3. For three countries (Belgium, Austria, Slovakia), the draft budgetary plans are found to be broadly compliant. While the countries are on track to correct their excessive deficits by the 2013 deadline, their plans might result in some deviation from the adjustment path towards the medium-term budgetary objective (MTO). The Commission invites the authorities to ensure full compliance with the SGP within the national budgetary process.
4. For five countries (Spain, Italy, Luxembourg, Malta, Finland), the draft budgetary plans pose a risk of non-compliance. For Spain and Malta, the plans contain risks as regards compliance to the EDP recommendations. For Italy there is a risk that on current plans the debt reduction rule would be breached in 2014. For Luxembourg and Finland there is a risk of significant deviation from the adjustment path towards the medium-term budgetary objective. The Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2014 budget will be fully compliant with the SGP and notably to address the risks identified in the assessment.
5. For the euro area as a whole, public debt is expected to stabilise. The large consolidation efforts implemented over the past years are now bearing fruit. Supported by the nascent recovery, the average headline budget balance is expected to be brought below the reference value of 3% of GDP. Those countries that face the largest fiscal challenges plan to implement the strongest consolidation efforts, showing some degree of differentiation according to fiscal space. However, only two Member States have attained their MTO, implying that further consolidation is necessary.
6. According to the plans, the aggregate fiscal effort, as expressed by the change in the cyclically adjusted budget balance net of one-off and temporary measures, would amount to ¼ % of GDP next year. While the low fiscal effort may point to an overall insufficient response to the euro area's fiscal challenges, the structural balance may underestimate the

total sum of fiscal measures due to a lower than normal response of revenue to economic growth and due to the current subdued growth of potential output in a medium term perspective.

7. Further structural reform is necessary to bolster the foundations for sustained growth. Member States should underpin their strategy towards sound public finances with structural reforms. Five of the euro-area countries that received revised EDP recommendations earlier in 2013 submitted Economic Partnership Programmes (EPPs) which outline the fiscal structural reforms that should support a lasting correction of their deficits. Overall, the EPPs show progress with respect to the improvement of national fiscal frameworks, mixed results with respect to tax reform and substantial reforms to pension and health systems, albeit not for all countries.

8. The budgetary plans still do not pay sufficient attention to the composition of fiscal consolidation. In particular, the general trend of decreasing public capital expenditure observed in the past few years, while stabilising, is not being reversed. Some focus on expenditure restraint is key in a well-designed consolidation strategy, especially where government sectors are relatively large. Continued progress with sound public finances should be supported by growth-friendly structural measures.

Table of Contents

I. Introduction

Over the last years, significant improvements in the EU economic governance have been implemented, which now provide for a coherent annual cycle of budgetary policy in Europe, with further steps for the euro area. In the first half of this cycle in spring, the European Semester, euro area Member States formulate their medium-term fiscal policies in the Stability Programmes, which the Commission assesses against the provisions under the Stability and Growth Pact. On the basis of recommendations by the Commission, the Council addresses recommendations to Member States, covering fiscal policy and structural reforms.

In the second half of the year, Member States are expected to implement the commonly agreed policies. With the aim to ensure the proper functioning of economic and monetary union, this autumn for the first time, euro area Member States submitted their draft budgetary plans (DBPs) for the forthcoming year to the Commission and to the Eurogroup. These plans summarise the content of the draft budgets that governments submitted to national parliaments.

In respect of the common timeline, thirteen euro area Member States sent their draft budgetary plans to the Commission by 15 October[1]. The four euro area countries under a macroeconomic adjustment programme are not obliged to submit a plan, as the programme already provides for close fiscal monitoring. On each plan, the Commission provides an opinion, assessing whether its content is consistent with the country's obligations with respect to the Stability and Growth Pact. It also provides an overall assessment of the budgetary situation and prospects for the euro area as a whole.

These opinions provide independent policy advice for national parliaments, during the budgetary process but in respect of their budgetary autonomy, and should help to better assess the compliance of the draft budgets with the commitments under the common fiscal rules. Taking the opinions into account is in the interest of Member States as, since 2011, the reinforced Stability and Growth Pact provides for stricter and earlier sanctions in case budgetary developments would breach the provisions of the Stability and Growth Pact. The reinforced economic governance now provides for a comprehensive toolbox to treat economic and budgetary policy as the matter of common concern as intended by the Treaty.

In July 2013, the Council invited the Eurogroup[2] to monitor and coordinate fiscal policies of the euro area Member States and the aggregate fiscal stance for the euro area as a whole to ensure a growth friendly and differentiated fiscal policy.

To this end, it invited the Eurogroup to discuss the Commission opinions of the draft budgetary plans of each of the euro area Member States, and the budgetary situation and prospects for the euro area as a whole on the basis of the overall assessment by the Commission of the draft budgetary plans and their interaction. The coordination should contribute to ensuring that the pace of fiscal consolidation is differentiated according to the fiscal and economic situation of the euro area Member States with the budgetary adjustment defined in structural terms in line with the Stability and Growth Pact, allowing the automatic stabilisers to function along the adjustment path and that, in view of reinforcing the credibility of fiscal policy over the medium term, fiscal consolidation is supported by an overall efficient

[1] This new requirement procedure is set out in Regulation (EU) No 473/2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area. It is one of the two Regulations in the so-called Two Pack which entered into force in May 2013.

[2] Council Recommendation of 9 July 2013 on the implementation of the broad guidelines for the economic policies of the Member States whose currency is the euro (OJ C 217, 30.7.2013, p. 97).

and growth-friendly mix of expenditure and revenue and by appropriate structural reforms which enhance the economic growth potential.

II. Overview of the Draft Budgetary Plans

The Commission's opinion on the draft budgetary plans focuses on compliance with the provisions of the Stability and Growth Pact and recommendations issued on its basis. For Member States in EDP, the Commission's opinion assesses whether the correction of the excessive deficit is on track. For euro area Member States that are in the preventive arm of the Stability and Growth Pact, i.e. not in Excessive Deficit Procedure, the progress towards the medium-term objective is assessed to see whether it is in line with the requirements of the SGP and the country-specific recommendations that were addressed to Member States in July.

The assessment is based on the Commission 2013 autumn Forecast. Table 1 summarises the assessments of individual countries' DBPs from the Commission opinions issued on 15 November together with the assessment of progress with fiscal reforms.

The Commission may request the submission of a revised draft budgetary plan where it identifies particularly serious non-compliance with the budgetary policy obligations laid down in the SGP in the original plan. This would be the case where the implementation of the draft budgetary plan would put the financial stability of the Member State concerned at risk, where it would risk jeopardising the proper functioning of the economic and monetary union, or where it would entail an obvious significant violation of the recommendations adopted by the Council under the SGP.

The Commission's assessment has not found any draft budgetary plan in serious non-compliance. Still, several of the submitted plans give rise to concerns. In order to allow for a comparative assessment, the assessment of the draft budgetary plans is summarised in for broad categories (Table 1). These are:

Compliant: according to the Commission 2013 autumn forecast, there is no need to adapt the budgetary plans within the national budgetary procedure to ensure compliance with the SGP rules

Compliant with no margin: according to the Commission 2013 autumn forecast, the DBP will just ensure compliance with the SGP requirements. While the Commission does not invite the authorities to take additional measures within the national budgetary process, the budget should be implemented rigorously. Should any slippage materialises compared to plans, the concerned Member States risks not complying with the SGP rules.

Broadly compliant: it concerns Member States that do not deliver the SGP-required adjustment towards their MTO according to the Commission 2013 autumn forecast. Should this situation persist over the years, it might lead to the concerned Member State being place in significant deviation procedure within the preventive arm. The Commission therefore invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2014 budget will be fully compliant with the SGP.

Risk of non-compliance: according to the Commission 2013 autumn forecast, the DBP is not likely to ensure compliance with the SGP requirements. The Commission therefore invites the authorities to take the necessary measures within the national budgetary process to address the identified risks by the Commission in its assessment of the draft budgetary plan to ensure that the 2014 budget will be compliant with the SGP.

Table 1: overview of individual Commission opinions on the Draft Budgetary Plans

Country	Overall compliance of Draft Budgetary Plan with Stability and Growth Pact			Overall compliance with the fiscal-structural reforms suggested in 2013 CSRs	
	Overall conclusion based on the Commission 2013 Autumn Forecast	**Compliance with the Excessive Deficit Procedure in 2013/2014**	**Compliance with the Preventive Arm requirements in 2014**	**Overall conclusion on progress towards fiscal-structural reforms**	**Progress on individual reforms in response to the structural part of the fiscal CSR since June 2013**
BE	Broadly compliant	Durable correction of the excessive deficit in 2013	Some deviation from the adjustment path towards the MTO	Limited progress	Limited action: Explicit coordination arrangements between federal and sub-federal levels
DE	Compliant	n.r.	MTO overachieved	No progress	No action on the structural parts of the fiscal CSR
EE	Compliant	n.r.	At MTO	Some progress	Progress: Budget-balance rule Limited action: Multi-annual expenditure rules and ceilings
ES	Risk of non-compliance	Fiscal effort delivered in 2013, at risk in 2014	n.r.	Some progress*	Progress: Independent fiscal institution; public sector arrears; indexation schemes; pension system; public administration reform; health care spending. Limited action: Comprehensive expenditure review; review of tax system
FR	Compliant with no margin	Fiscal effort delivered both in 2013/2014	n.r.	Limited progress*	Progress: Pension system Limited action: Spending review; tax system; decentralisation
IT	Risk of non-compliance	n.r.	Compliance with the debt benchmark in 2013, at risk in 2014	Limited progress	Limited action: Public expenditure; tax policy
LU	Risk of non-compliance	n.r.	Significant deviation from MTO	Some progress	Progress: Medium-term budgetary framework
MT	Risk of non-compliance	Headline target met in 2013, fiscal effort at risk in both 2013/2014	n.r.	Limited progress*	Progress: Fiscal framework; efficiency of public administration (adoption and implementation risks remain); healthcare (information is inconclusive) Limited action: Pension system

NL	Compliant with no margin	Fiscal effort delivered both in 2013/2014	n.r.	Some progress*	Progress: Fiscal framework; housing market (implementation of past reforms) Limited action: Pension system; tax credits and allowances
AT	Broadly compliant	Durable correction of the excessive deficit in 2013	Some deviation from adjustment path towards the MTO	Some progress	Progress: Pension system; labour market Limited action: Linking pension benefits to changes in life expectancy; harmonisation of pension ages
SI	Compliant with no margin	Fiscal effort delivered both in 2013/2014	n.r.	Limited progress*	Progress: Tax system; fiscal framework; long-term care Limited action: Pension system
SK	Broadly compliant	Durable correction at risk in 2014 – Fiscal effort delivered	Some deviation from adjustment path towards the MTO	Limited progress	Progress: Tax system (collection) Limited action: Pension system; tax policy; health care; budgetary rules
FI	Risk of non-compliance	n.r.	Significant deviation from adjustment path towards the MTO, breach of the 60% threshold in 2014	Some progress	Progress: Public sector efficiency; finances of the municipal sector; pension reform

Legend: n.r.: not relevant

* This Member State submitted an Economic Partnership Programme.

III. Main aggregate findings

The public finances of the thirteen euro area member states which submitted a draft budgetary plan (EA-13) have improved overall (Table 2). According to the national plans, the aggregate **headline budget deficit** is expected to decrease by 0.7 p.p. of GDP, reaching 2.7% of GDP this year. This will be the first time that it falls below the 3% of GDP threshold since 2008. This has been the result of a continuous improvement in the EA-13 structural budgetary position since 2011, with the overall **structural balance** being set to improve by a further 0.7 p.p. this year according to the DBPs. In turn, the **debt-to-GDP** ratio for EA-13 will continue to increase this year, albeit at a slower pace, and reach 93.0% in 2013.

The DBPs[3] show that the public debt is finally stabilising as a percentage of GDP in 2014, despite limited consolidation in 2014. According to the macroeconomic scenarios underlying the DBPs, 2014 should see a return to growth, which is consistent with the Commission' autumn forecast. The average **headline deficit** for the EA-13 is planned to reach 2.3% GDP in 2014 (0.4 p.p. lower than in 2013), ranging from a slight surplus in Germany to a deficit of 3.6% in France, 5.8% in Spain and 6.7% in Slovenia[4]. Most importantly, the **debt-to-GDP ratio** for EA-13 is expected to stabilize in 2014 at around 93% GDP[5] – while ranging from 132.7% in Italy, followed by Belgium (100.2%) and Spain (98.9%), to as low as 26.1% in Luxembourg and 10.0 % in Estonia.

Table 2: Overview table of economic and budgetary aggregates (EA-13) for 2013 and 2014.

	2013			2014		
	Stability Programmes	Draft Budgetary Plans	Commission 2013 autumn forecast	Stability Programmes	Draft Budgetary Plans	Commission 2013 autumn forecast
Real GDP growth (% change)	-0.2	-0.4	-0.3	1.3	1.2	1.1
Headline deficit (% GDP)	-2.7	-2.7	-2.8	-1.9	-2.3	-2.5
Δ Structural Balance (p.p. GDP)	0.8	0.7	0.6	0.5	0.3	0.2
Debt (% GDP)	92.2	93.0	92.9	91.8	93.0	93.5
Expenditure ratio (% GDP)	50.4	50.0	49.8	49.1	49.5	49.6
Revenue ratio (% GDP)	47.7	47.2	47.1	47.1	47.2	47.1

3 The overall conclusions are subject to three qualifications. First, they reflect the plans of thirteen (EA-13) rather than all seventeen of the euro area countries. Greece, Ireland, Portugal and Cyprus are not covered by the requirement to submit their DBPs, due to their macroeconomic assistance programmes. Second, Germany, Austria and Luxembourg (accounting for 34% of the GDP of the EA-13), submitted their plans according to a no-policy change scenario, linked to national elections. For these three countries, the DBPs are not a clear guide to the governments' policy intentions. Finally, within the overall averages that this document focuses on, there are significant cross-country differences, even in the cases where they are not explicitly flagged.

4 See table A1 in Annex IV.

5 See table A3 in Annex IV. Annex II contains sensitivity analyses.

For 2014 the DBPs the structural consolidation effort – measured by a positive change in the structural balance – of 0.3 p.p. of GDP. This is less than envisaged by Member States in their Stability Programmes[6]. Given that eleven of the thirteen countries are either under Excessive Deficit Procedure or have not yet attained their MTO[7], this may point to an overall insufficient response to the euro area's fiscal challenges. This conclusion however should be qualified, as the structural balance may underestimate the underlying fiscal effort on grounds of a lower than normal response of revenue to economic growth and the current subdued growth of potential output in a medium term perspective.

Within the overall figure of 0.3 p.p., the countries that are facing the largest fiscal challenges, in terms of their deficits exceeding 3% of GDP and their debt levels lying well above 60%, plan to implement the largest consolidation efforts, showing some degree of differentiation. The overall adjustment is indicative of a broadly neutral fiscal stance, which should contribute to the recovery.

The analysis of the DBPs indicates that the consolidation plans do not pay sufficient attention to the impact of the composition of consolidation measures; a rebalancing towards more growth-friendly fiscal measures should be possible.

Five of the euro-area countries that received revised EDP recommendations earlier in 2013 (Spain, France, the Netherlands, Malta and Slovenia) submitted Economic Partnership Programmes which outline the fiscal structural reforms that they intend to implement to support a lasting correction of their deficits. These focus primarily on fiscal reforms. Overall, the EPPs show progress with respect to improvement in national fiscal frameworks, mixed results with respect to tax reform and substantial reforms to pension and health systems, albeit not for all countries. Annex III presents a more detailed overview of their content.

In terms of the **composition** of next year's small adjustment, EA-13 DBPs show a reduction in the expenditure-to-GDP ratio for 2014, while the revenue-to-GDP ratio should stabilise after having repeatedly increased since 2010. Similarly, the tax-to-GDP ratio is now expected to stabilise in 2014 after continuous increases in the last three years.

The details of the measures included in the DBPs indicate that average planned changes in the composition of **expenditure** compared to 2013 are rather small[8]. In particular, the DBPs envisage slight reductions in expenditure on compensation of employees (-0.2% GDP), social payments, intermediate consumptions and capital expenditure (by -0.1% each), whereas expenditure on subsides will remain stable and interest expenditure should increase slightly (by 0.1%). For capital expenditure, the largest reductions are planned in Estonia, Slovakia and France. The fact that capital expenditure is still envisaged to decline both in these countries and, although marginally, overall for the fifth year in a row, may enter in contradiction with the objective of moving to a more growth-friendly public spending structure.

Measures concerning **taxation,** as announced in the DBPs, should bring some small changes to the tax composition in the EA-13. In particular, revenue from indirect taxation should

---

6 Consistency between the medium-term budgetary plans set forth in the Stability Programmes and the fiscal policy decisions contained in the DBPs for 2014 is an essential pre-requisite for the stability and predictability of fiscal policy. In this sense, comparing EA-13 fiscal targets as presented in the DBPs with the ones laid down in the Stability Programmes shows the consistency between Member States' medium-term plans and their annual budgets. Nevertheless, it should be borne in mind that some Member States (amongst the EA-13 countries, this is the case for Belgium, Spain, France, Malta, the Netherlands and Slovenia) which were issued new recommendations in the context of their Excessive Deficit Procedures last June, had to update their fiscal plans in response.

7 The medium-term budgetary objective (MTO) is the cornerstone of the preventive arm of the Stability and Growth Pact.

8 See graph A1 in Annex IV

increase, while revenues from direct taxes are projected to fall, due to decreasing revenue from capital taxes. In turn, the share of social contributions should remain stable in relation to GDP. These limited changes in the composition of revenues, partly due to the implementation of tax reforms in some Member States (e.g. France, Netherlands or Slovenia), may be seen as being more growth friendly, as the indirect taxes, mainly levied on consumption, are expected to increase while the more distortive tax burden on labour and capital is expected to fall slightly in 2014.

The comparison between the EA-13 DBPs for 2014 and Commission's autumn forecasts for next year allows an assessment of the possible risks to the realization of Member States' fiscal plans.

At the aggregate EA-13 level, the draft plans are broadly in line with Commission's forecast, with a marginal aggregate difference of 0.2 p.p. of GDP[9]. Differences between the DBPs and the Commission headline deficit forecast however are larger at Member State level, for reasons varying from one country to another. Malta stands out with a 1.3 p.p. smaller headline deficit target for 2014 than forecast by the Commission, followed by Belgium and Luxembourg (0.5 p.p.) and Austria, Slovenia, Slovakia and Finland (0.4 p.p.). Differences in the foreseen structural balances are the main drivers in the cases of Malta and Slovakia Finally, Estonia is the only Member State in the EA-13 where Commission's forecasts point to a lower deficit in 2014 than the country's own DBP (-0.1%, as opposed to -0.4%), and there is no difference in the forecasts for the Netherlands.

---

9 See graph A3 and A4 in Annex IV.