Part I

Developments in public finances in EMU in 2019

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KEY FINDINGS

This part provides an overview of the public finance developments in 2019, i.e. before the COVID-19 outbreak.

The budgetary positions of some Member States in 2019 warranted SGP procedural steps.

- Following the abrogation of Spain's excessive deficit procedure in June 2019, for the first time since 2002, no Member State was subject to an excessive deficit procedure at the end of 2019.
- Hungary and Romania were still subject to significant deviation procedures in 2019.
- None of the 2020 draft budgetary plans submitted by euro area Member States were found to be in particularly serious non-compliance with the Stability and Growth Pact's requirements. However, the draft budgetary plans of eight Member States could result in a significant deviation from their adjustment paths towards their respective medium-term budgetary objectives and, in four of these cases, in an insufficient reduction in their high levels of public debt.

Key indicators of the preventive arm of the SGP were revised in 2019.

- In February 2019, the Economic and Financial Committee agreed on a new methodology to compute the minimum benchmark, one of the key components of the minimum medium-term budgetary objective (MTO). The new methodology is more stable, exhibits better properties.
- The minimum MTOs were revised accordingly for the period 2020-2022. The majority of Member States have set a more demanding MTO than required by their minimum MTO. However, the activation of the General Escape Clause in March 2020, has allowed for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term.

Well-designed spending reviews can foster sustainable growth.

- Spending reviews are increasingly being used in the euro area, mostly to improve the quality of public services and foster sustainable growth.
- A Commission survey on spending rules shows improvements in political commitment and process coordination, but weaknesses in terms of monitoring and consistency with the budgetary process.
- A spending review for investment could be an important tool to screen priorities within investment spending.

Automatic stabilisers can smooth a sizeable part of cyclical fluctuations.

- Automatic stabilisers can significantly offset cyclical fluctuations: In the EU, they offset an average of around 30–50% of any loss in household disposable income and up to 30% of any loss in GDP.
- However, there are considerable differences across Member States. Overall, evidence shows that automatic stabilisers are larger in the EU than in the US.

Public finances can play an important role in the transition to a climate-neutral economy and healthy planet.

- On the one hand, the mitigation and adaptation investments and the social policies needed to help the citizens and regions most affected by the transition imply higher public expenditure. On the other hand, carbon pricing instruments to address distorted price signals may raise revenues and cut expenditure by phasing out fossil fuel subsidies.
- Green budgeting can contribute to a mainstreaming of green budgetary policies and processes by linking budgetary tools and environmental and climate change goals.
- The Commission is exploring ways to integrate the risks associated with climate change and the transition to a carbon-neutral economy into its debt sustainability analysis framework.

1. IMPLEMENTATION OF FISCAL SURVEILLANCE IN 2019

EU fiscal surveillance is designed to ensure sound public finances in Member States. It involves the Council and the Commission assessing Member States' compliance with the Stability and Growth Pact. The Pact has two different sets of requirements. First, its corrective arm requires Member States to keep their general government deficit below the reference value of 3% of GDP, and their general government debt below 60% of GDP, or to reduce general government debt sufficiently to approach 60% at a satisfactory pace. Member States have to prompt a correction of their excessive deficit if those two criteria are not met ([2])([3]). Second, the Pact's preventive arm requires Member States to achieve and maintain their medium-term budgetary objective, which corresponds to a cyclically-adjusted target for the budget balance, net of one-offs and temporary measures ([4]). Country-specific medium-term budgetary objectives are defined so as to secure the sustainability of public finances and allow the automatic stabilisers to operate without breaching the reference value for the deficit as defined in the Treaty.

([2]) Article 126 TFEU sets out the excessive deficit procedure, which is further specified in Regulation (EC) 1467/97 'on speeding up and clarifying the implementation of the excessive deficit procedure', amended in 2005 and 2011.

([3]) A Member State is not compliant with the debt criterion if its general government gross debt exceeds 60% of GDP and it is not cutting that debt sufficiently to approach 60% of GDP at a satisfactory pace. The concepts of '*sufficiently diminishing*' and '*satisfactory pace*' are crucial in assessing compliance with the debt criterion of Member States whose general government gross debt exceeds 60% of GDP. Regulation 1467/97 states that these requirements are met if '*the differential [of the general government gross debt] with respect to the reference value has decreased over the previous three years at an average one twentieth per year as a benchmark*'. The Regulation provides that '*the requirement under the debt criterion shall also be considered to be fulfilled if the budgetary forecasts of the Commission indicate that the required reduction in the differential will occur over the three-year period encompassing the two years following the final year for which data are available*'. It further indicates that '*the influence of the cycle on the pace of debt reduction*' should be taken into account. However, it is not automatically decided to start an excessive deficit procedure on that basis, as the Commission has to take account of a long list of relevant factors, detailed in Article 2(3) of Regulation (EC) No 1467/97.

([4]) The preventive arm of the Stability and Growth Pact is set out in Regulation (EC) 1466/97 'on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies', which was amended in 2005 and 2011.

This chapter summarises the main developments in the implementation of fiscal surveillance in the EU in 2019.[5] First it presents key developments and procedural steps taken under the corrective arm's excessive deficit procedure (Section 1.1.) and the preventive arm's significant deviation procedure (Section 1.2.). It then summarises the 2019 country-specific recommendations on fiscal policy (Section 1.3.). Finally, it presents the Commission's assessment of the euro area Member States' draft budgetary plans for 2020 (Section 1.4.).

1.1. EXCESSIVE DEFICIT PROCEDURE

This section focuses on the implementation of the excessive deficit procedure in 2019. Under this procedure, Member States are recommended to correct their excessive deficit and debt positions, measured against the reference values of 3% and 60% of GDP. Country-specific developments are summarised in Tables I.A.1, I.A.2, I.A.3 and I.A.4. in the Annex ([6]).

1.1.1. Euro area Member States

On 5 June 2019, the Commission adopted reports pursuant to Article 126(3) TFEU on Belgium, France, Italy and Cyprus.

The Commission report of June 2019 on Italy concluded that the debt criterion should be considered as not complied with. According to notified data for 2018 and the Commission spring 2019 forecast, Italy's gross government debt reached 132.2% of GDP in 2018, well above the 60% reference value, and the country did not comply with the debt reduction benchmark in 2018. Moreover, both Italy's 2019 stability programme and the Commission spring 2019 forecast projected that the debt-to-GDP ratio would not comply with the debt reduction benchmark in either 2019 or 2020. The Commission report of 5 June 2019 concluded that the debt criterion as defined in the Treaty should be considered as not complied with and that a debt-based excessive deficit procedure was therefore warranted. The Commission reached this

([5]) The main developments in fiscal surveillance in 2020 will be covered in the Report on Public Finances in EMU 2020.

([6]) The Commission's website details all country-specific developments pertaining to the excessive deficit procedure.

conclusion after examining all relevant factors, namely (i) non-compliance with the recommended adjustment path towards the medium-term budgetary objective in 2018 based on *ex-post* data, together with a risk of significant deviation from the preventive arm requirement in 2019 and a headline deficit above 3% of GDP in 2020 based on the Commission spring 2019 forecast; (ii) the macroeconomic slowdown recorded in Italy from the second half of 2018, which could only partly explain Italy's large gaps to compliance with the debt reduction benchmark; and (iii) Italy's limited progress in addressing the 2018 country-specific recommendations, including its backtracking on past growth-enhancing reforms, and the lack of details of the commitments set out in Italy's 2019 National Reform Programme.

Following Italy's updated fiscal plans of 1 July 2019, the Commission issued a communication on 3 July 2019 concluding not to start an excessive deficit procedure for Italy at that stage. The Italian authorities' updated fiscal plans included revenues that were higher than expected and public expenditure that was lower than expected resulting from the budget execution in 2019. A further guarantee for lower expenditure was a new clause to freeze spending in case of underachievement of the new fiscal target. Those updates corresponded to a structural improvement of around 0.2% of GDP, compared to a deterioration of 0.2% of GDP in the Commission spring 2019 forecast. Italy was thus expected to be broadly compliant with the required effort under the preventive arm of the Stability and Growth Pact in 2019. Furthermore, in a letter sent to the Commission on 2 July 2019, the Italian authorities committed to achieving a structural improvement in 2020, by ensuring that the VAT hike legislated as a safeguard clause for that year would be fully replaced by offsetting fiscal measures, including a spending review designed to reduce expenditure and a revision of tax expenditures. The Commission communication of 3 July 2019 concluded that the package of measures was sufficient not to propose the opening of a debt-based excessive deficit procedure to the Council at that stage. The Commission noted that it would check the effective implementation of that package by closely monitoring the execution of the 2019 budget and by assessing the compliance of the 2020 draft budgetary plan with the Stability and Growth Pact. It would also assess progress in implementing the structural reforms referred to in the country-specific recommendations in the context of the European Semester. These were key to ensuring higher economic growth and thereby helping to reduce the debt-to-GDP ratio.

The Commission report of June 2019 on Belgium concluded that the analysis was not fully conclusive as to whether or not the debt criterion was complied with. According to notified data for 2018 and the Commission spring 2019 forecast, gross government debt stood at 102% of GDP in 2018, well above the 60% reference value in the Treaty and Belgium did not comply with the debt reduction benchmark in 2018. Moreover, the Commission spring 2019 forecast projected that Belgium would not comply with the debt reduction benchmark in 2019 and 2020.

After examining all relevant factors, the Commission report concluded that analysis was not fully conclusive as to whether or not the debt criterion was complied with. The following relevant factors were examined: (i) the macroeconomic conditions, which were no longer considered a factor to explain Belgium's gap to the debt reduction benchmark; (ii) the implementation of growth-enhancing structural reforms in past years, several of which were considered substantial and which were projected to help improve debt sustainability, even if they had a temporary non-neutral budgetary impact; and (iii) the lack of sufficiently robust evidence to conclude whether there was a significant deviation from Belgium's adjustment path towards the medium-term budgetary objective in 2018, and over 2017 and 2018 taken together, owing to high uncertainty as to the extent of the temporary nature of the evolution of corporate income tax revenues.

The Commission report of June 2019 on France concluded that the deficit and debt criteria defined in the Treaty should be considered as complied with. According to notified data for 2018 and the Commission spring 2019 forecast, gross government debt stood at 98.4% of GDP in 2018, well above the 60% reference value, and France made insufficient progress in 2018 towards compliance with the debt reduction benchmark. Moreover, the headline general government deficit was planned to increase to 3.1% of GDP in 2019, remaining close to, though exceeding, the reference value of 3% of GDP. The excess was not considered exceptional, although it was marginal and temporary for the purposes of the Treaty and the Stability and Growth Pact. Moreover, the increase in the deficit to 3.1% was solely due to the one-off statistical impact of transforming the tax credit for competitiveness and employment (CICE) into a permanent outright reduction in employers' social contributions. After examining all relevant factors, the report concluded that the deficit and debt criteria should be considered as complied with. The following relevant factors were examined: (i) France was found to be broadly compliant with the recommended adjustment path towards the medium-term budgetary objective in 2018; (ii) short-term sustainability risks were low; (iii) the breach of the reference value (3% of GDP) in 2019 was marginal, temporary and solely due to a one-off effect, and (iv) growth-enhancing structural reforms had been implemented in the last years, in response to the country-specific recommendations addressed to France.

The Commission report of June 2019 on Cyprus concluded that further steps leading to a decision on the existence of an excessive deficit should not be taken. According to notified data for 2018 and the Commission spring 2019 forecast, the general government headline balance in Cyprus reached a deficit of 4.8% of GDP in 2018, much above the Treaty reference value of 3% of GDP. The excess over the reference value was not considered exceptional, although it was temporary within the meaning of the Treaty and the Stability and Growth Pact. In the absence of the 8.3% of GDP one-off impact of the banking support measures, the general government balance would have amounted to a surplus of 3.5% of GDP in 2018. Furthermore, according to the Commission spring 2019 forecast and Cyprus's 2019 stability programme, the general government headline balance was projected to return to surpluses of around 3% of GDP in 2019 and above 2.5% of GDP in 2020, in compliance with and well below the Treaty reference value. Cyprus was also expected to be compliant with the debt reduction benchmark in 2019 and 2020. The relevant factors could not be taken into account in the steps leading to the decision on the existence of Cyprus's excessive deficit; as the government debt-to-GDP ratio exceeded the 60% reference value, the deficit did not remain close to the reference value. Overall, however, the Commission considered that further steps leading to a decision on the existence of an excessive deficit for Cyprus should not be taken, since the opening of an excessive deficit procedure would not have served any meaningful purpose for fiscal surveillance.

For the first time since 2002, no euro area Member States are undergoing the excessive deficit procedure. The excessive deficit procedure for Spain was abrogated on 14 June 2019, as the deficit had been brought below 3% of GDP in 2018 and it was projected to stay below 3% in 2019 and 2020 ([7]). According to the Commission autumn 2019 forecast, the headline deficits were projected to be below the Treaty reference value (3% of GDP) in all euro area Member States but France in 2019.

1.1.2. Non-euro area Member States

No non-euro area Member State were subject to excessive deficit procedures in 2019. Government deficits in nearly all non-euro area Member States were below 3% of GDP in 2018. The sole exception was Romania, with a headline deficit of 3% of GDP. According to the Commission autumn 2019 forecast, government deficits were expected to remain below 3% of GDP in 2019 in all non-euro Member States but Romania, where the general government deficit was projected to reach 3.6% of GDP (Section I.1.2.).

1.2. SIGNIFICANT DEVIATION PROCEDURE

A significant deviation procedure is launched if a Member State has deviated significantly from its medium-term budgetary objective or the adjustment path towards it, on the basis of outturn data. When such a deviation is observed, the Commission must issue a warning. Within one month, the Council must issue a recommendation to the Member State concerned to take measures to tackle the deviation.

In 2019, new significant deviation procedures were launched for Hungary and Romania, based on the deviation observed in 2018 (Table I.A.4.). The Council also concluded that both Member States did not take effective action in response to the Council Recommendations of

([7]) OJ L 163, 20.6.2019, p. 59.

4 December 2018 with a view to correcting the observed significant deviation.

Hungary has been subject to a significant deviation procedure since June 2018. On 14 June 2019 the Council adopted a decision establishing that no effective action had been taken in response to its recommendation of December 2018 ([8]). After Hungary had failed to take effective action in response to the Council recommendation of 22 June 2018 ([9]), the Council adopted a revised recommendation on 4 December 2018. This called on Hungary to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure did not exceed 3.3% in 2019, corresponding to an annual structural adjustment of 1.0% of GDP. Hungary was asked to report to the Council by 15 April 2019 on action taken ([10]).

On 20 March 2019, the Commission undertook an enhanced surveillance mission in Hungary. The mission report concluded that the Hungarian authorities did not plan to act on the Council recommendation. On 15 April 2019, the Hungarian authorities submitted a report on action taken, in which they reiterated that their target for 2019 remained a headline deficit of 1.8% of GDP. However, the report did not comply with the Council's reporting requirements, and the improvement in the underlying structural deficit fell significantly short of what was recommended. As the overall assessment based on the Commission spring 2019 forecast confirmed a deviation from the recommended adjustment, on 14 June 2019 the Council adopted a decision that Hungary had not taken effective action in response to its recommendation of 4 December 2018.

On the basis of a Commission recommendation, on 14 June 2019 the Council also adopted a new recommendation for Hungary with a view to correcting the significant observed deviation from the adjustment path towards the medium-term budgetary objective ([11]). The Commission spring 2019 forecast and the 2018 outturn data indicated that Hungary had deviated significantly from the required adjustment path towards the medium-term budgetary objective in 2018. Hungary was recommended to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure did not exceed 3.3% in 2019 and 4.7% in 2020, corresponding to an annual structural adjustment of 1% of GDP in 2019 and 0.75% in 2020. The country was also recommended to use any windfall gains to reduce the deficit, while budgetary consolidation measures should secure a lasting improvement in the general government structural balance in a growth-friendly manner. Hungary was recommended to report on action taken to the Council by 15 October 2019. On 26 September 2019, the Commission undertook an enhanced surveillance mission under Article 11(2) of Regulation (EC) No 1466/97. The mission report concluded that the Hungarian authorities planned to act on the Council recommendation only with respect to the year 2020. On 15 October 2019, in line with the deadline set by the Council, the Hungarian authorities submitted a report on action taken in response to the Council recommendation of 14 June 2019. The report did not comply with the reporting requirements recommended by the Council.

In line with Commission recommendations, the Council adopted a decision on 5 December 2019 establishing that Hungary had not taken effective action, plus a revised recommendation on measures to take to correct the significant deviation ([12]). Based on the Commission 2019 autumn forecast, Hungary was projected to deviate from the recommended adjustment for 2019, while it was projected to achieve the recommended adjustment in 2020. Consequently, on 20 November 2019 the Commission adopted a recommendation for a Council decision establishing that no effective action had been taken and a revised recommendation for a Council recommendation. Acting on those recommendations, the Council called on Hungary to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 4.7% in 2020, corresponding to an annual structural adjustment of 0.75% of GDP. Hungary should also use any windfall gains for deficit reduction and to compensate for unexpected revenue shortfalls with high-quality permanent fiscal measures.

([8]) OJ L 163, 20.6.2019, p. 64.
([9]) OJ C 223, 27.6.2018, p. 1.
([10]) OJ C 460, 21.12.2018, p. 4.
([11]) OJ C 210, 21.6.2019, p. 4.
([12]) OJ L 329, 19.12.2019, p. 91 and OJ C 420, 13.12.2019, p. 1.

Furthermore, budgetary consolidation measures should secure a lasting improvement in the general government structural balance in a growth-friendly manner. Hungary was asked to report to the Council by 15 April 2020 on action taken in response to the recommendation.

Romania has been subject to a significant deviation procedure since June 2017. Based on a Commission recommendation, in June 2019 the Council adopted a decision establishing that Romania had taken no effective action in response to its recommendation of 4 December 2018 ([13]). That recommendation had called on Romania to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure did not exceed 4.5% in 2019, corresponding to an annual structural adjustment of 1% of GDP. Romania was asked to report on action taken to the Council by 15 April 2019 ([14]). On 14 and 15 March 2019, the Commission undertook an enhanced surveillance mission in Romania. The mission report concluded that the Romanian authorities did not intend to act on the Council recommendation. On 20 April 2019, after the deadline set by the Council, the Romanian authorities submitted a report on action taken in which they reiterated that they were targeting a headline deficit of just below 3% of GDP in 2019 and only a marginal decrease in the structural deficit. However, the fiscal impact of the reported measures fell significantly short of what was recommended. As the overall assessment based on the Commission spring 2019 forecast confirmed a deviation from the recommended adjustment by a wide margin, the Council adopted a decision on 14 June 2019 stating that Romania had not taken effective action in response to its recommendation of 4 December 2018.

Following a recommendation by the Commission, on 14 June 2019 the Council also adopted a new recommendation for Romania with a view to correcting the significant deviation observed in 2018 ([15]). In 2018, based on the Commission 2019 spring forecast and the 2018 outturn data, Romania was found to have deviated significantly from the required adjustment path towards the medium-term budgetary objective. Moreover, the general government deficit was projected to reach 3.5% of GDP in 2019 and 4.7% of GDP in 2020, thus exceeding the Treaty reference value (3% of GDP). The Council concluded that the failure to act on earlier recommendations and the risk of exceeding the reference value called for urgent action to put Romania’s fiscal policy back on a prudent path. Romania was therefore recommended to ensure that the nominal growth rate of net primary government expenditure did not exceed 4.5% in 2019 and 5.1% in 2020, corresponding to an annual structural adjustment of 1% of GDP in 2019 and 0.75% of GDP in 2020. Romania was also recommended to use any windfall gains to reduce its deficit and secure a lasting improvement in the general government structural balance in a growth-friendly manner. Finally, Romania was recommended to report to the Council by 15 October 2019 on action taken. On 25 September 2019, the Commission undertook an enhanced surveillance mission in Romania. The mission report found that the authorities planned to undertake structural adjustment only from 2022 and thus did not intend to act on the recommendation. On 15 October 2019, the Romanian authorities submitted a report on action taken. The report did not comply with the reporting requirements, as it contained no comprehensive projection of individual budgetary categories, nor did it include the budgetary impact of each measure mentioned. Overall, the fiscal impact of the reported measures fell short of the requirements.

In line with Commission recommendations, the Commission adopted a decision on 5 December 2019 establishing that Romania had not taken effective action, plus a revised recommendation on measures to take to correct the significant deviation ([16]). Based on the Commission autumn 2019 forecast, the projected fiscal effort fell short of the requirements in both 2019 and 2020. Moreover, the Commission projected a general government deficit of 3.6% in 2019 and 4.4% in 2020, thus exceeding the reference value (3% of GDP). Consequently, the Council called on Romania to take the necessary measures to ensure that the nominal growth rate of net primary government expenditure does not exceed 4.4% in 2020, corresponding to an annual structural adjustment of 1.0% of GDP, thereby putting the

([13]) OJ L 163, 20.6.2019, p. 62.
([14]) OJ C 460, 21.12.2018, p. 1.
([15]) OJ C 210, 21.6.2019, p. 3.
([16]) OJ L 324, 13.12.2019, p. 5 and OJ C 420, 13.12.2019, p. 4.

country on an appropriate adjustment path towards the medium-term budgetary objective. Romania should use any windfall gains to reduce its deficit, and budgetary consolidation measures should secure a lasting improvement in the general government structural balance, in a growth-friendly manner. Romania should report to the Council by 15 April 2020 on action taken in response to the recommendation.

1.3. FISCAL COUNTRY-SPECIFIC RECOMMENDATIONS

According to the 2019 Stability and Convergence Programmes submitted in April 2019, 23 Member States would be at or above the medium-term budgetary objective by 2022, compared with the 12 which reached this in 2018. Of the 12 Member States that had reached their medium-term budgetary objective in 2018, all would remain at or above their medium-term budgetary objective in 2022, with nine of them planning a fiscal expansion in the course of the programme. However, some highly indebted Member States, such as Spain, France and Italy, have stated that they plan to remain far from their medium-term budgetary objective by the end of the programme period.

Based on the Member States' programmes, the aggregate headline deficit would be slightly below the 2018 deficit level by the end of the programme. The headline deficit would rise to 0.9% of GDP in both the EU and the euro area in 2019. After this, it would decline to a deficit of 0.4% of GDP in the EU and 0.3% in the euro area by 2022. It is expected that the (recalculated) aggregate structural balance will have worsened in 2019 by around 0.2 pps. of GDP in both the EU and the euro area. In contrast, it is expected to improve by 0.3 pps. of GDP in last year's programmes. The (recalculated) structural balance is projected to improve but to remain in deficit in 2022, at 0.5% of GDP in the EU and 0.6% in the euro area.

Based on the Commission spring 2019 forecast, risks to the Member States' programmes are expected to increase in 2020. While risks to the budgetary projections for 2019 seem limited, the Member States' budgetary targets for 2020 were more favourable than the Commission forecast. The latter projected an aggregate headline deficit of 1.0% of GDP in the EU (0.9% of GDP in the euro area). This is 0.4 pps. (0.4 pps.) higher than in the Member States' programmes. The assessment of the future budgetary measures ('policy gap') accounts for most of the difference.

On 28 March 2019 the Council adopted the recommendations for the euro area as a whole, to allow the euro area dimension to be taken into account in the Member States' national reform and stability programmes and in the country-specific recommendations.

On the basis of the information provided in the 2019 stability and convergence programmes (and in the national reform programmes), the Council adopted country-specific recommendations to all 28 Member States on 9 July 2019, as part of the 2019 European Semester. This was the first time that country-specific recommendations were addressed to Greece, following its exit from the third macroeconomic adjustment programme in August 2018 ([17]).

The Council recommended that Member States comply with the requirements of the Stability and Growth Pact. Guidance on how to achieve the medium-term budgetary objective or to make sufficient progress towards it was provided in terms of the maximum allowed nominal growth rate of net primary government expenditure and the corresponding adjustment in the structural balance. No fiscal recommendation was made to Member States that were expected to be at or above their medium-term budgetary objective in 2020. For those undergoing a significant deviation procedure (Hungary and Romania), the recommendations called for compliance with the respective Council decisions under those procedures. In addition, Member States with large debt-to-GDP ratios were recommended to use windfall gains to accelerate the reduction of the general government debt ratio. In the area of fiscal-structural policies, some Member States were recommended to take measures to ensure the sustainability of the pension, healthcare, or long-term care systems. The Council also

([17]) Under Article 12 of Regulation (EU) No 472/2013, Member States that are subject to a macroeconomic adjustment programme are exempt from the monitoring and assessment of the European Semester for economic policy coordination under Article 2(a) of Regulation (EC) No 1466/97 for the duration of that programme.

recommended that some Member States improve the efficiency and composition of public spending, improve tax collection, strengthen fiscal frameworks, and broaden the tax base towards more growth-friendly taxes. All country-specific recommendations concerning fiscal matters are set out in Table I.A.5.

1.4. DRAFT BUDGETARY PLANS

In October 2019, all euro area Member States submitted their draft budgetary plans for the 2020 budgetary year, which were then assessed by the Commission. All euro area Member States submitted their draft budgetary plans broadly in time. Austria, Portugal and Spain submitted no-policy-change draft budgetary plans because of national elections held between the end of September and the first half of November 2019. Belgium also submitted a no-policy-change draft budgetary plan, as it is in the process of forming a new government.

While no draft budgetary plan was found in particularly serious non-compliance, some draft budgetary plans gave rise to concerns about the planned fiscal effort. The Commission sent letters requesting further information to Finland on 14 October 2019 and to Belgium, France, Italy, Spain and Portugal on 22 October 2019. The letters set out some preliminary observations on their draft budgetary plans. In the cases of Belgium, Spain and Portugal, they also underlined the importance of submitting updated draft budgetary plans. Finland replied on 16 October and France and Italy on 23 October 2019. The information in their replies was taken into account in the Commission's assessment of budgetary developments and risks. Overall, the assessments of the draft budgetary plans flagged up different degrees of risk. The Commission opinions called on the Member States to take appropriate action where necessary to ensure compliance with the Stability and Growth Pact.

The assessment of the plans was summarised in three broad categories: (i) 'compliant', (ii) 'broadly compliant' and (iii) 'at risk of non-compliance'. For all Member States, the compliance assessments for 2020 were made against the requirements of the preventive arm and based on the Commission autumn 2019 forecast. Table I.A.6 sets out the Commission's opinions.

Nine draft budgetary plans were found to be 'compliant' with the requirements under the Stability and Growth Pact. They were submitted by the following Member States: Germany, Ireland, Greece, Cyprus, Lithuania, Luxembourg, Malta, the Netherlands and Austria. In the case of Germany and the Netherlands, in view of the size of their fiscal space, the Commission invited the authorities to undertake additional expenditures to support an upward trend in investment and to focus investment-related economic policy on those areas recommended by the Council in the context of the European Semester.

The draft budgetary plans of two Member States –Estonia and Latvia– were found to be 'broadly compliant' with the requirements of the Stability and Growth Pact. Latvia's draft budgetary plan might result in some deviation from its medium-term budgetary objective, while Estonia's plan might result in some deviation from the adjustment path towards it. If Latvia's structural balance is no longer projected to be close to the medium-term budgetary objective in future assessments, the overall assessment of compliance will need to take into account the extent of the deviation from the requirement set by the Council.

Finally, the draft budgetary plans of eight Member States were found to be 'at risk of non-compliance' with the Stability and Growth Pact's requirements. In the case of Belgium, Spain, France and Italy, those risks relate both to the insufficient reduction of the high level of public debt and the projected significant deviation from the adjustment path towards their respective medium-term budgetary objectives. For Portugal, Slovenia, Slovakia and Finland, public debt has either been brought below the Treaty reference value (60% of GDP) or is on an appropriate path towards it. Those Member States also achieved a budgetary balance that provides a sizeable margin towards the Treaty reference value (3% of GDP). Nonetheless, the implementation of the draft budgetary plans of these euro area Member States might result in a significant deviation from the adjustment path towards their respective medium-term budgetary objectives.

2. MINIMUM BENCHMARKS AND MINIMUM MEDIUM-TERM BUDGETARY OBJECTIVES – AN UPDATE

2.1. INTRODUCTION

The preventive arm of the Stability and Growth Pact (SGP) supports Member States in achieving sound budgetary positions by setting a budgetary target, known as the medium-term budgetary objective (MTO). The MTO is differentiated across Member States and pursues a threefold objective. First, it must account for evolving long-term sustainability challenges; second, it provides a safety margin with respect to the 3% of GDP deficit limit; and finally, it should allow room for sufficient budgetary manoeuvre, taking particular account of the need for public investment ([18]).

The country-specific MTO is determined by three components.

- First, the minimum benchmark component (MTO^{MB}) provides a safety margin to the 3% of GDP (headline) deficit criterion.
- Second, the implicit liabilities and debt component (MTO^{ILD}) reflects the need to contain or reduce current and future debt.
- Third, for members of the euro area and ERMII, there is a supplementary lower limit of -1% of GDP ([19]).

The *minimum* MTO corresponds to the most demanding value of the three components defined above, rounded to the less stringent quarter percentage point. Member States are free to set a more ambitious MTO in their stability (and convergence) programmes.

This Chapter presents the updated values of the minimum MTOs and one of its key components, the minimum benchmark (MB). The minimum benchmark was revised applying a new methodology, which was agreed by the Economic and Financial Committee (EFC) in February 2019. The update of the minimum MTO follows the regular institutional calendar, which foresees an update every 3 years ([20]). The revised minimum benchmarks and MTOs will be used in the fiscal surveillance process to assess budgetary positions from 2020 onwards.

The rest of this chapter is structured as follows: Section I.2.2. describes and assesses the changes in the MB methodology and presents the updated MBs. Section I.2.3. shows the updated minimum MTOs. Finally, Section I.2.4. sets out conclusions.

2.2. NEW MINIMUM BENCHMARKS

2.2.1. Concept

The key purpose of the minimum benchmark is to ensure sustainable fiscal positions that provide Member States sufficient fiscal space to let automatic stabilisers operate freely. The MB is an indicator used in the EU fiscal surveillance process that operationalises the concept of a safety margin, mentioned in the secondary legislation. The MB indicates the budgetary position in structural terms that provides a safety margin for Member States under the preventive arm of the SGP to avoid incurring excessive deficits under the corrective arm of the SGP in normal cyclical fluctuations. This should make sure that Member States have sufficient budgetary manoeuvre vis-a-vis the 3% deficit reference value to let the automatic stabilisers, features of the tax and benefit system, play freely (Part II.4.) ([21]).

The minimum benchmark is assessed for each Member State based on the following two factors ([22]):

- ***Past business cycle volatility***. Member States with larger swings in the economic cycle should have a larger safety margin, i.e. a larger

([18]) See Article 2(a) of Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, OJ L 209, 2.8.1997, p. 1–5.

([19]) Signatory parties of the Treaty on Stability, Coordination and Governance (TSCG) additionally committed to an even lower limit of -0.5% of GDP unless the debt ratio is well below 60% of GDP and there are low sustainability risks.

([20]) The update is typically conducted following the publication of the Commission's Ageing Report or after reforms with a significant impact on sustainability.

([21]) Mohl et al. (2019), European Commission (2017), Dolls et al. (2012).

([22]) Council of the European Union (2017).

minimum benchmark. The output gap provides an estimate of the difference between potential and actual GDP in each particular year, which can be used to assess the volatility of the economic cycle.

- ***Responsiveness of the government budget to past business cycle fluctuations***: Member States with a stronger response to cyclical conditions (e.g. due to a sizeable government budget) should have a larger safety margin. The responsiveness of the government budget to output fluctuations is represented by the fiscal semi-elasticity. It measures the percentage change of the budget balance-to-GDP ratio that corresponds to a one percent change in the level of output ([23]).

2.2.2. Methodology

2006 methodology

The 2006 methodology was introduced in the context of the 2005 reform of the SGP. The Commission introduced the MB concept in 2000 to provide Member States with an indication of how to operationalise the concept of a safety margin. Following the 2005 reform of the SGP and the introduction of the safety margin concept as one of the criteria to define the country-specific MTOs, Member States invited the Economic Policy Committee to explore methodological improvements to the MB. A method for calculating the MB was agreed in September 2006 ('the 2006 methodology') and has been applied consistently between 2006 and 2019.

Under the 2006 methodology, past business cycle fluctuations were assessed using the concept of a representative output gap (ROG). The MB was calculated as follows:

$$\mathrm{MB}_i = -3 - \varepsilon_i * ROG_i$$

where the responsiveness of the general budget to the business cycle was measured by the semi-elasticity of the budget (ε_i) and past business cycle volatility was represented by the 'representative output gap'.

The ROG measures past *negative* cyclical conditions that Member States experienced in times of normal business cycles. It reflects the fact that the volatility of the economic cycle differs across Member States, which has an impact on budget balances. The ROG was calculated as follows:

$$ROG_i = \frac{N_i}{N_i + N_T} P^{5\%}(OG_i) + \frac{N_T}{N_i + N_T} P^{5\%}(OG_{EU})$$

where $P^{5\%}(OG_i)$ and $P^{5\%}(OG_{EU})$ represent the fifth percentile of the distribution of the country-specific and EU common output gap series, respectively. Ni stands for the number of country-specific observations since EU membership, whereas *NT* refers to the available observations at EU level, respectively over a 25-year rolling time window (i.e. *NT* was set at 25). The relative weights of the country-specific and common components in the equation could differ across Member States due to limited data availability (for instance for the more recently acceded Member States).

Outliers were removed for the calculation of the ROG. The percentile of the country-specific and EU common components were calculated after deleting outlier values. These were defined as observations below the 2.5% and above the 97.5% percentiles of the entire EU sample of output gaps, i.e. considering all the available observations for Member States in the past 25 years. In addition, the most negative output gap value of each Member State recorded between 2009 and 2010 was also removed from the country-specific series, as the Great Recession years cannot be considered as *normal* negative cyclical fluctuations.

New methodology

In February 2019, the EFC agreed on a new methodology. The Commission prepared several options to address design flaws of the 2006 methodology and discussed them with Member States. The new methodology for calculating the MBs in the fiscal surveillance process was agreed by the EFC on 1 February 2019. It will be used to assess budgetary positions from 2020 onwards.

([23]) The size of the fiscal semi-elasticity depends on non-cyclical government expenditure (as a share of potential GDP), the size of cyclical unemployment benefits and the progressivity of the tax system; see Mourre et al. (2019); Mourre and Poissonnier (2019).

The new methodology addresses design flaws in the measurement of past business cycle volatility. The new MB methodology addresses two design flaws of the 2006 methodology: (i) the MB had become more stringent and volatile for most Member States and (ii) there was no longer any correlation between the MB and the country-specific volatility of the economic cycle ([24]).

Under the new methodology, the minimum benchmark is calculated as follows:

$$\mathrm{MB}_i = -3 + 1.2\,\frac{stdev(\varepsilon_i * OG_i) + stdev(\varepsilon_{EU} * OG_{EU})}{2}$$

$$subject\ to -0.7\ \geq \mathrm{MB}_i \geq\ -1.5$$

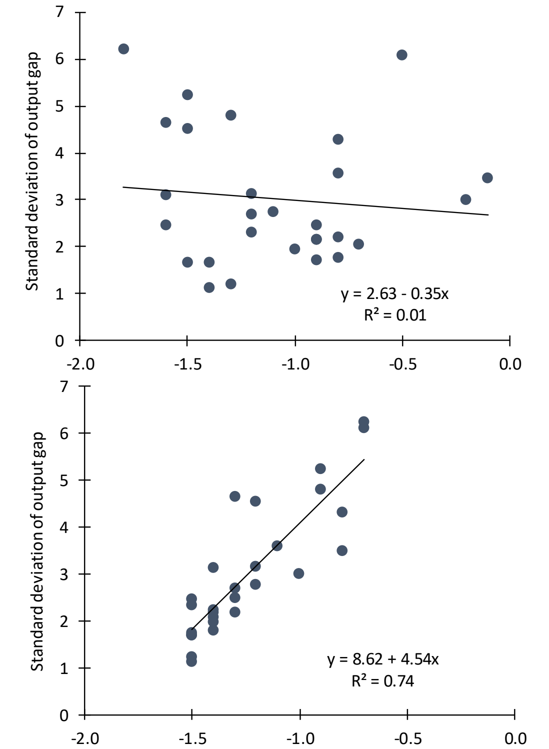
This implies that the safety margin with respect to the 3% of GDP deficit reference value is now calculated as the simple average of the standard deviation of the country-specific and EU common cyclical components of the budget balance since 1985 multiplied by a coefficient of 1.2. That coefficient was chosen to ensure that the new methodology did not lead to a significant loosening of the MBs relative to the 2006 methodology. The new methodology includes an MB floor of -1.5% and a MB ceiling of -0.7% to avoid excessively lenient or stringent MBs ([25]).

Assessment of the new methodology

The new methodology has two key benefits: First, it ensures stability. The new methodology is more stable as it is based on a longer time window. It is also less sensitive to outliers, since it is based on the standard deviation rather than the 5th percentile of the distribution.

Second, it ensures a positive correlation between the minimum benchmark and the volatility of the economic cycle (Graph I.2.1). The new methodology exhibits a positive relationship between the minimum benchmark and the volatility of the economic cycle for two reasons: First, the volatility of the cycle, as measured by the standard deviation of the output gap, is one of the main determinants of the new MB methodology. Second, the new methodology assigns a higher weight on average to the country-specific component relative to the 2006 methodology.

Graph I.2.1: **Correlation between the volatility of the output gap and the minimum benchmarks (2006 vs. new methodology)**



The new methodology ensures broadly similar MBs for 2020 for the EU on average, but significant differences exist for some Member States (Table I.2.1). While the impact of the change in methodology is modest for the EU on average, there are more sizeable differences for some Member States. In particular, the MB has tightened significantly in Greece, as outliers are no longer removed from the calculation. In general, there has been a tightening of MBs in Member States with greater past output volatility and a

([24]) Those flaws were related to two factors. First, the gradual incorporation of the significant negative output gaps recorded during the Great Recession in the 25-year rolling time window led to a significant downward adjustment of the ROG and the minimum benchmark. That tightening appeared unwarranted, as these negative output gaps were clearly not representative of normal cyclical conditions. Second, the fact that the output gap outliers were trimmed using the entire EU sample implied that the negative output gap outliers (those below the 2.5% percentile) trimmed at EU level were those recorded in a small number of Member States, especially in Greece.

([25]) The corridor corresponds to the EU average for the MB when using 1 and 1.5 standard deviations of the cyclical component of the budget balance, respectively.

loosening in Member States with less volatile economies ([26]).

New minimum benchmarks for 2020

The MBs for 2021 are largely unchanged compared to 2020 (Table I.2.1**).** The updated results for 2021 are largely unchanged confirming one of the key benefits of the new methodology, namely the greater stability of the results.

Table I.2.1: **Minimum benchmarks under the 2006 and new methodology**

Year	2020			2021	
Methodology	old (2006)	new (2020)	Difference old vs. new	new (2020)	Difference 2001 vs. 2000
	(a)	(b)	(c=b-a)	(d)	(e=d–b)
BE	-1.3	-1.5	-0.2	-1.5	0.0
BG	-1.6	-1.3	0.3	-1.3	0.0
CZ	-1.6	-1.5	0.1	-1.5	0.0
DK	-0.9	-1.3	-0.4	-1.3	0.0
DE	-1.5	-1.5	0.0	-1.5	0.0
EE	-0.5	-0.7	-0.2	-0.7	0.0
IE	-1.1	-1.2	-0.1	-1.2	0.0
EL	-1.8	-0.7	1.1	-0.7	0.0
ES	-0.1	-0.8	-0.7	-0.9	-0.1
FR	-0.8	-1.4	-0.6	-1.4	0.0
HR	-1.2	-1.2	0.0	-1.2	0.0
IT	-0.7	-1.4	-0.7	-1.4	0.0
CY	-0.8	-0.8	0.0	-0.8	0.0
LV	-1.5	-0.9	0.6	-0.9	0.0
LT	-1.3	-0.9	0.4	-0.9	0.0
LU	-1.2	-1.3	-0.1	-1.3	0.0
HU	-1.2	-1.5	-0.3	-1.4	0.1
MT	-1.4	-1.5	-0.1	-1.5	0.0
NL	-0.9	-1.5	-0.6	-1.5	0.0
AT	-1.4	-1.5	-0.1	-1.5	0.0
PL	-0.8	-1.4	-0.6	-1.4	0.0
PT	-0.9	-1.3	-0.4	-1.2	0.1
RO	-1.5	-1.2	0.3	-1.4	-0.2
SI	-0.8	-1.1	-0.3	-1.1	0.0
SK	-1.6	-1.4	0.2	-1.4	0.0
FI	-0.2	-1.0	-0.8	-1.1	-0.1
SE	-0.9	-1.4	-0.5	-1.4	0.0
EU27	*-1.1*	*-1.2*		*-1.2*	
St.dev.	*0.4*	*0.3*		*0.3*	
UK	-1.0	-1.4	-0.4	-1.4	0.0

Minimum benchmarks will continue to be updated on an annual basis. Given their importance for the fiscal surveillance process, MBs are scheduled to be updated every year ([27])([28]).

2.3. NEW MINIMUM MEDIUM-TERM BUDGETARY OBJECTIVES

The updated minimum MTOs reveal three features (Table I.2.2). The minimum MTO results for the period 2020-2022 incorporate up-to-date projections for ageing costs from the Commission's 2018 Ageing Report ([29]) and MBs for 2020 computed with the new methodology described earlier.

First, for most Member States, the new minimum MTO is the same or more stringent than before. Compared to the minimum MTOs for 2017-2019, the new minimum MTOs are unchanged for 10 Member States (AT, CY, DK, ES, FI, FR, LT, LV, NL and SK), more stringent for 9 Member States (BE, BG, CZ, EE, HR, IT, LU, HU and RO) and less stringent for 7 Member States (DE, IE, MT, PL, PT, SI and SE). In the case of Greece, the calculation of the minimum MTO for 2020-2022 is the first since Greece exited the ESM Stability Support Programme.

Second, the implicit liabilities and debt component is the most demanding component for most Member States. The most binding component is the implicit liabilities and debt component for 13 Member States (AT, BE, BG, CY, CZ, DE, EL, HU, IT, LU, MT, PT and SI), followed by the minimum benchmark for 9 Member States (EE, ES, FI, HR, LV, LY, PL, SE and RO) and the lower limit of -1% of GDP for euro area and ERM II Member States for 5 Member States (DK, FR, IE, NL and SK) ([30]).

Finally, the majority of Member States have set a more demanding MTO than required by their minimum MTO. The majority of Member States have set their current MTOs for 2020-2022 at levels that are more demanding than required by their minimum MTOs. This is partly due to Member States that are signatories of the Fiscal Compact, which in many cases requires setting an MTO above the minimum MTO ([31]). However, it also confirms that the minimum MTO is not a recommendation of a medium-term budgetary target but rather a lower bound to ensure sustainable public finances.

([26]) Four Member States are impacted by the floor of -1.5% (AT, BE, DE and MT) while two Member States are affected by the ceiling of -0.7% (EE and EL).

([27]) MBs are an eligibility condition for granting access to the structural reform and investment clause in the preventive arm of the SGP.

([28]) While the MB is updated on an annual basis, its contribution to the minimum MTO is only updated every 3 years along with the other minimum MTO components.

([29]) European Commission (2018b).

([30]) As the minimum MTOs are rounded to the less stringent quarter, a number of MS are in practice equally constrained by two or more components.

([31]) Bulgaria and Croatia have chosen a more demanding MTO because they aim to join the ERM2.

Table I.2.2: **Updated minimum MTOs for 2020-2022**

Country	Old minimum MTO 2017-2019	Minimum MTO 2020-2022	Binding factor*	MTO set for 2020-2022	Applicability of the Fiscal Compact**
BE	-0.50	0.00	ILD	0.00	Yes
BG	-2.25	-1.25	ILD	-1.00	Yes
CZ	-1.50	-0.75	ILD	-0.75	No
DK	-1.00	-1.00	EA-ERM2	-0.50	Yes
DE	-0.50	-1.00	ILD	-0.50	Yes
EE	-1.00	-0.75	MB	-0.50	Yes
IE	-0.50	-1.00	EA-ERM2	-0.50	Yes
EL* **	NA	0.25	ILD	0.25	Yes
ES	-1.00	-1.00	MB	0.00	Yes
FR	-1.00	-1.00	EA-ERM2	-0.40	Yes
HR	-1.75	-1.25	MB	-1.00	No
IT	-0.50	0.50	ILD	0.50	Yes
CY	-1.00	-1.00	ILD	0.00	Yes
LV	-1.00	-1.00	MB	-1.00	Yes
LT	-1.00	-1.00	MB	-1.00	Yes
LU	-1.00	0.50	ILD	0.50	Yes
HU	-1.50	-1.00	ILD	-1.00	No
MT	-0.50	-1.00	ILD	0.00	Yes
NL	-1.00	-1.00	EA-ERM2	-0.50	Yes
AT	-0.75	-0.75	ILD	-0.50	Yes
PL	-1.25	-1.50	MB	-1.00	No
PT	0.25	0.00	ILD	0.00	Yes
RO	-1.75	-1.25	MB	-1.00	Yes
SI	0.25	-0.25	ILD	-0.25	Yes
SK	-1.00	-1.00	EA-ERM2	-1.00	Yes
FI	-1.00	-1.00	MB	-0.50	Yes
SE	-1.25	-1.50	MB	-1.00	No
UK	-0.75	-0.50	ILD	-0.50****	No

Notes: Those values represent a lower bound for the MTOs to be nominated by Member States in their SCPs. In order to promote ownership of the MTOs, it is up to each Member State to choose an MTO that reflects its individual needs.
* Binding factor refers to the component that gives rise to the most demanding value for the minimum MTO (ILD = lower bound taking into account implicit liabilities and debt; EA-ERM2 = lower bound for euro area or ERM2 Member States; MB = minimum benchmark).
** Contracting parties that are bound by the Fiscal Compact. They are subject to more stringent MTO-related requirements than the one envisaged in the SGP. A limit of -0.5% of GDP is required except for Member States with debt significantly below 60% of GDP and where risks in terms of long-term sustainability of public finances are low, in which case a limit of -1.0% is possible.
*** MTO to be set for the first time since the economic adjustment programme.
**** For the UK this is based on the minimum MTO since the MTO has not been set in the convergence programme.

2.4. CONCLUSIONS

This Chapter presents the updated values of the minimum MTO and one of its key components, the minimum benchmark. The minimum benchmark was revised applying a new methodology, which was agreed by the Economic and Financial Committee (EFC) in February 2019. The revised minimum benchmarks and MTOs will be used in the fiscal surveillance process to assess budgetary positions from 2020 onwards. The minimum MTOs were updated for the period 2020-2022 in line with the regular institutional calendar.

The new minimum benchmarks are similar to those computed with the old methodology for the EU on average, but significant differences exist for some Member States. The new MB methodology addresses two flaws of the 2006 methodology. Specifically, the 2006 methodology showed a great deal of instability from one year to another and there was no longer any correlation with the country-specific volatility of the economic cycle. While the impact of the change in methodology is modest for the EU on average, there are more sizeable differences for some Member States. In general, with the new methodology, there has been a tightening of MBs in Member States with greater past output volatility and a loosening in Member States with less volatile economies. This is a desirable feature for a safety margin. Incidentally, by removing the two-step calculation and using a well-established statistical concept (standard deviation), the new methodology has provided a marginal simplification to the EU fiscal rules.

For most Member States, the new minimum MTO is the same or more stringent than before. The majority of Member States have set a more demanding MTO than required by their minimum MTO.

3. LATEST DEVELOPMENTS IN SPENDING REVIEWS FOR THE EURO AREA

3.1. BACKGROUND

This chapter reviews the latest developments in spending reviews, which can be an effective way of fostering sustainable growth. In times of stretched public finances and low potential growth, it is essential to improve the composition and efficiency of public expenditure in order to make fiscal policies as growth-friendly as possible ([32]). Spending reviews can provide in-depth insights into budget allocations. If well-designed and rigorously-implemented, they can be an effective means of boosting high-quality public spending and enhance sustainable growth. They can make room for more investment by suppressing or reducing non-priority expenditure items, and their scrutiny of expenditure items can also improve the value for money of investment programmes ([33]).

The Eurogroup encouraged the use of spending reviews in 2016 ([34]). In September 2016, the Eurogroup endorsed a set of common principles for improving expenditure allocation. They called for (i) a strong and sustained political commitment throughout the entire spending review process; (ii) using best practices in the design and implementation phases of the review; (iii) the need for continuous monitoring and communicating on progress; and (iv) consistency with the budgetary cycle. On those grounds, the Eurogroup invited its preparatory committees and the Commission to develop a work stream on the exchange of best practices and lessons learned on spending reviews.

3.2. COMMISSION SURVEY ON SPENDING RULES

General results of the survey

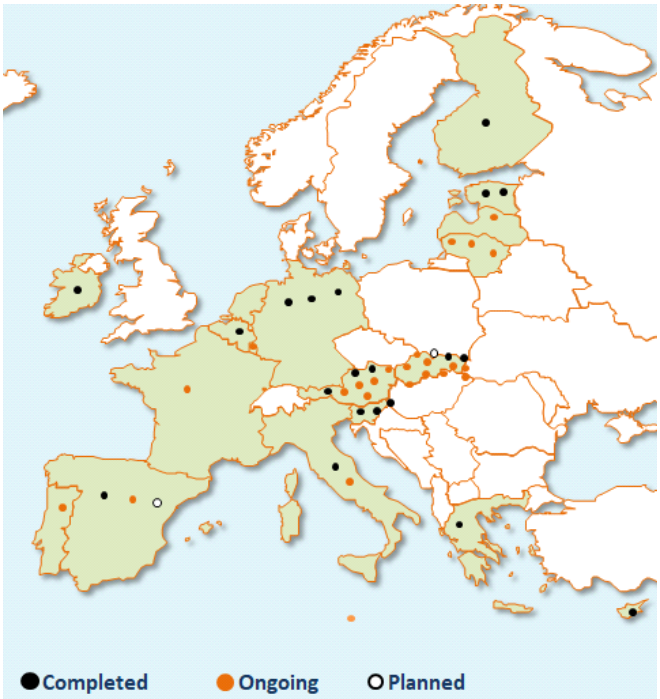
According to a 2019 Commission survey, spending reviews are increasingly used in the euro area, mostly to improve the quality of public services ([35]). A 2019 Commission survey points to a wider use of spending reviews than in the past, with 46 reviews reported in the questionnaire, up from the 30 spending reviews reported in 2017. In some cases, those reviews are said to be conducted as part of regular or multiannual processes. Most reviews focus on specific spending items, such as social and educational programmes, healthcare or public services, while only one review in six covers all public expenditure, or a large share of it. A major objective for those reviews is to improve the quality of public services and promote spending reallocation to other or new policies, followed by fiscal consolidation and growth-enhancing goals.

The survey points to some progress in the conduct of those reviews in 2019 compared to 2017, but challenges remain. Political commitment is stronger than in 2017, although it is weaker in the implementation phase. New forms of coordination are being developed, with greater use of a permanent coordination unit or task force. Although the use of fact-based analyses still seems to be limited, diagnoses are increasingly based on comprehensive analyses. Monitoring and evaluation are still weak, but media coverage is quite frequent, focusing mainly on reform decisions. Only a minority of euro area Member States report that they have incorporated decisions from spending reviews into their budget planning. The practice of spending reviews is well-established in law and/or in administrative processes in only a few Member States. Finally, compared to 2017, more attention seems to be given to growth and equity concerns, as well as to satisfaction among the general public, in particular when developing reform options.

Some reviews are already bearing fruits. As implementation is still ongoing, the results are not yet tangible for most reviews. Only 24 reviews are at a result phase, and the objectives could be said to have been met for only 3 of these, since the implementation of proposed reforms is still under way for many of the others. Nonetheless, interesting reforms have already emerged from the spending review exercise in some Member States.

([32]) Afonso et al. (2005), Cepparulo and Mourre (2020).
([33]) Vandierendonck (2014).
([34]) European Council (2016).
([35]) European Commission (2019a).

Graph I.3.1: **Overview of spending reviews (euro area, 2019)**



Note: The graph indicates the number of spending reviews reported in the 2019 survey by Member States (for 18 euro area Member States). Reviews are said to be 'completed' if reform options have been presented or implemented by April 2019, and finished over the past 2 years. They are 'ongoing' if the scrutiny of expenditure items is conducted, and 'planned' if a mandate has been issued but the examination of expenditure items has not started.
Source: European Commission survey 2019.

Examples for interesting reforms are:

- centralised procurement systems in Italy, Portugal and Spain;
- the creation of an enterprise gateway for enterprises and more resources to support innovation in Estonia;
- reform of the care insurance scheme (*assurance dépendance*) and merging of public research institutions in Luxembourg;
- reduced electricity costs for the Greek government and improvements in the use of land;
- improved maintenance of water pipes in Cyprus and;
- more equitable allocation of resources to regional schools in Slovakia.

The survey points out that there is still much to be done to better align spending review practices with common principles. Commitment during the implementation phase of spending reviews is particularly weak, with many respondents indicating as major challenge during the implementation the absence or lack of clarity of decisions from the political level. Further, implementation would strongly benefit from a larger use of roadmaps, as recommended in the Eurogroup common principles, which would provide guidance and predictability in carrying out the reforms. Monitoring and evaluation are still lacking and when they are carried out, they focus mostly on processes while failing to assess the impact of these reviews on outcomes. When an assessment of outcomes could be provided, in most cases, objectives are said to be met only to a limited extent. Furthermore, the link with budgetary process continues to be weak, while institutionalising spending reviews within the budgetary process proves to enhance their success and can have a positive impact on budget preparation as well. Challenges remain as regards availability of data, resources (in terms of both

Box I.3.1: **Key features for effective spending reviews**

Asked what was particularly effective in their spending reviews, Member States pointed to some important elements that help make them more successful.

Commitment: High-level political ownership was particularly important, as was the communication of the mandate, seen as a major factor in building internal and external support.

Open discussions with stakeholders: Discussions with all stakeholders from the outset of the process are a key factor to the effectiveness of spending reviews, as they can encourage stakeholders to think 'outside the box'. Line ministries and stakeholders should be encouraged to propose changes, with no limits on the number of proposals or the size/type of measure: '*no measure is too small to be rejected*'.

Empowering line ministries: It is key to secure the engagement of line ministries early in the process using a cross-departmental approach, and to grant them some room for manoeuvre in the process. In Germany, a collaborative process where line ministries had to work jointly turned out to be beneficial for the entire review, encouraging an open and fair exchange of views and a common search for solutions. In Finland, cooperation between line ministries and the Ministry of Finance was said to be quite effective and boosted awareness of the detailed items of the government budget.

Independence and diversity of the task force conducting the review: The independence of the task force is key to the process and, to this end, it is particularly important not to pre-set any results, so as to fully transfer the ownership of the exercise to those involved. In practice, it helps to have external and independent stakeholders with a clear mandate to propose measures without necessarily taking into account the official view of the institutions. Having a variety of skills, and members from the academic and business worlds, along with top civil servants, enriches the outcomes of the task force.

A roadmap with deadlines and a multiannual perspective. Having a well-planned roadmap with a calendar for regular meetings and tight deadlines seems to have been a major recipe for success. Strategically aligning the publication of spending review papers with the annual budgetary process was effective in terms of providing evidence to inform the negotiation process.

Conditions for generating results: Other success factors are:

(i) joint treatment of policy design and implementation considerations, selecting what to scrutinise based on what could be feasible to reform;

(ii) use of accounting data and cross-cutting of multiple databases to feed into concrete proposals with an impact assessment; and

(iii) reviewing performance indicators during the evaluation.

skills and staff) and time for the proper conduct of spending reviews.

Specific case of investment-oriented spending reviews

Spending reviews designed to improve the efficiency of public investment are quite relevant for the euro area, given its overall limited fiscal space and high investment needs. Council recommendations on the economic policy in the euro area emphasise the importance of investment –both public and private– in the context of effective and efficient public expenditure ([36]). More recently, the Eurogroup has politically agreed on the main features of the budgetary instrument for convergence and competitiveness (BICC) for the euro area ([37]),

([36]) European Commission (2017b).
([37]) European Council (2019).

which is part of a larger package that aims to promote structural reforms and public investment. As the BICC takes shape, there is a collective interest in the euro area in reviewing and improving the performance of private and public investment, in particular with a view to boosting innovation, competitiveness and convergence.

To date, there are few spending reviews designed to improve investment. Ireland has recently conducted a comprehensive revision of its capital stock, through the 2016-2021 Capital Plan Review ([38]). Based on submissions from ministries and stakeholders, that review identifies priorities for future capital spending. The exercise was also supported by an assessment by the Irish Government Economic and Evaluation Service on the adequacy of the current capital stock. In 2016, Slovakia launched a review of its transport infrastructure, which identified a series of shortcomings in the sector, including lack and inaccuracy of data, poor conditions for roads and railways and lack of coherence between different modes of transport ([39]). The review recommended improved project evaluation, through better data gathering and disclosure, and cost-benefit analyses.

Some specific features of investment need to be borne in mind when conducting spending reviews for public investment ([40]). First, since capital spending means changes in assets, an examination of the stocks is warranted ([41]). Unlike current spending, investment relates to both stocks and flows. Looking at stocks raises besides those commonly examined for current spending, including ownership, maintenance and depreciation of the stock. Second, investment has a time dimension, as it usually spans over a number of years. An investment programme or project typically involves several phases: planning, financing, implementation or execution, and evaluation ([42]). The focus of a review tends to change along those phases. While the bulk of financing decisions are taken at the planning phase, many changes also occur during implementation, with financing being possibly increased or reduced, and at times some projects that are part of the programme sometimes even being abandoned. Finally, investment yields medium- to long-term economic and social returns. Since those returns, and the entire project execution, entail some risks, performance budgeting should be extended to include an assessment of returns and risks.

3.3. CONCLUSIONS

In brief, spending reviews can promote sustainable growth if well-designed and rigorously implemented. Spending reviews are increasingly used in euro area Member States. As the 2019 Commission survey shows, the conduct of those reviews seems to have improved compared to 2017. Political commitment appears stronger, and governments are setting up new types of coordination unit to manage the spending review process. There is still room for improvement in implementation, through the development of roadmaps and a stronger political commitment. Also, a more frequent monitoring focused on results as well as process would enhance the effectiveness of the reviews. Spending reviews can also be a means of boosting good-quality public investment. A spending review for investment could improve the performance of private and public investment in the euro area.

([38]) Irish Government Economic and Evaluation Service (2017).
([39]) Slovak Ministry of Finance (2016).
([40]) Public investment is expressed by gross fixed capital formation, namely government acquisitions, less disposal, of tangible and non-tangible assets. Tangible assets include dwellings, other buildings and structures, machinery and equipment, and cultivated biological resources. Intangible assets comprise R&D, computer software and databases, intellectual property rights, entertainment and literary originals. Its expenditure category counterpart is capital expenditure, and more precisely investment expenditure, which includes gross capital formation, plus acquisitions less disposals of non-produced non-financial assets.
([41]) European Commission (2019b).
([42]) European Commission (2017b).

4. AUTOMATIC STABILISERS IN EUROPE – AN OVERVIEW

4.1. INTRODUCTION

Fiscal policy can make an important contribution to stabilising the economy, in particular in times of constrained monetary policy. The 2007-2008 economic and financial crisis has revived the debate on the importance of fiscal policy as a tool for stabilising economic activity in times of deep crisis. The current low interest rate environment and impaired monetary transmission channel have spurred renewed interest in the cushioning role of fiscal policy.

There are two ways to conduct countercyclical fiscal policy ([43]).

First, automatic stabilisers can help smooth cyclical fluctuations at unchanged policies. They work through automatic countercyclical changes in tax revenues and government expenditure, based on the rules built into the tax and transfer system at unchanged legislation. During economic downturns, tax revenues (mainly income taxes) decline, while government expenditure rises (particularly due to unemployment benefits). This supports income, consumption and GDP and worsens the government budgetary position. Conversely, during booms, tax revenues rise, while government spending tends to decline. This has a curtailing effect on income, demand and GDP, and improves the government budgetary position. The crucial question is whether automatic stabilisers can deliver a significant degree of output stabilisation, especially in the event of large shocks.

Second, discretionary fiscal policy measures can be designed in a countercyclical manner to smooth output fluctuations. When used in a timely and targeted fashion, discretionary action can play an important role in stabilising the economy following a large negative shock, especially if monetary policy is constrained by the effective lower bound. In practice, however, effective implementation of discretionary measures can face a number of obstacles, including implementation lags, procyclical bias, and/or poorly targeted measures. Furthermore, discretionary measures are not automatically reversed when the economic cycle improves, which may be a potential source of future fiscal imbalances. These measures should therefore only be used in case of clearly identified needs (e.g. in the event of large shocks) and when there is sufficient fiscal space, to prevent risks to the sustainability of public finances.

This chapter reviews the size of automatic stabilisers in the European Union ([44]). Section 4.2. reviews the literature on the size of automatic stabilisers. Finally, Section 4.3. summarises the main findings.

4.2. HOW SIZEABLE ARE AUTOMATIC STABILISERS IN EUROPE?

Two main approaches have been used in the literature to analyse the effectiveness of automatic stabilisers. The first, microeconomic-based, approach analyses the stabilisation properties of the tax and benefit system using micro, i.e. household, data. This approach focuses on the *direct* stabilisation effect on disposable income and consumption. This literature typically assumes a certain shock to market income (i.e. before taxes and benefits) and quantifies the direct stabilisation effect of the tax and benefit system on household disposable income and consumption using a microsimulation model ([45]). The second, macroeconomic-based, approach concentrates instead on the *total,* i.e. *direct* and *indirect* stabilisation properties based on macro data. It focuses on the stabilisation effect on GDP and its components, taking into account

([43]) Mohl et al. (2019).

([44]) We examine the case of Italy, since it represents a large EU economy with a size of automatic stabilisers close to the EU average and good data availability. The implications of high pension expenditure in Italy and of the degree of tax compliance are not analysed in this chapter but are interesting avenues for future work.

([45]) Knieser and Ziliak (2002), Auerbach (2009).

behavioural responses (affecting for instance labour supply or consumption decisions) and macroeconomic feedback (e.g. affecting inflation, GDP or employment) ([46]).

Microeconomic studies find that the tax and benefit system automatically smooths around 30-50% of the loss in disposable income for the EU as a whole, with sizeable differences across Member States. Dolls et al. (2012) find that in the EU the tax and benefit system absorbs 38% of the effects of an income shock and 47% of the effects of an unemployment shock on disposable income ([47]). The effects on household demand are 4-22% for an income shock and 13-30% for an unemployment shock, depending on assumptions on liquidity constraints. The authors also find substantial heterogeneity within the EU, with automatic stabilisers in eastern and southern Europe being considerably smaller than in central and northern European countries. Using a similar micro approach, the European Commission (2017a) concludes that in the EU on average around 33% of a shock to market income is absorbed by the tax and benefit system and hence not transmitted to disposable income ([48]).

Macroeconomic studies find that the tax and benefit system stabilises up to 30% of GDP fluctuations in Europe as a whole, with sizeable differences existing across Member States. Barrell and Pina (2004) find that automatic stabilisers smooth output by 11% in the euro area, while the study by Barrell et al. (2002) finds a value of 9% ([49]). Van den Noord (2000) reports a degree of smoothing effectiveness between 25% and 30%, while in 't Veld, Larch and Vandeweyer (2013) estimate that automatic stabilisers smooth economic fluctuations by 13-27% ([50]). Estimates for individual Member States are also wide-ranging. For example, Brunila et al. Veld (2003) find for a sample of EU countries that the smoothing capacity of automatic stabilisers is in the 20-30% range for a consumption shock, and 3-10% for an investment shock ([51]). Buti et al. (2002) find a value of 14% for Belgium and 22% for France, while Tödter and Scharnagl (2004) estimate a degree of stabilisation of up to 26% for Germany ([52]). The European Commission (2017) concludes that automatic stabilisers smooth around 6% of GDP fluctuations for a combination of productivity and export shocks in Italy.

Overall, automatic stabilisers appear larger in the EU than in the US. Based on a microeconomic approach, Dolls et al. (2012) find that in the US automatic stabilisers absorb 32% of the effects on disposable income of an income shock (38% in the EU) and 34% of an unemployment shock (47% in the EU). Using a macroeconomic approach, Cohen and Follette (2000) conclude that automatic stabilisers dampen only about 10% of the effect of aggregate demand shocks on US real GDP. McKay and Reis (2016) find that stabilisers have had little effect on the volatility of output and hours worked in the US but have lowered the volatility of aggregate consumption ([53]).

Several factors explain the differences in the estimated size of automatic stabilisers. These include:

- ***Direct versus total effects*** *(micro- and macro-based approach):* Overall, automatic stabilisers tend to be larger in the microeconomic than in the macroeconomic approach. This is because the microeconomic approach focuses on the *direct* stabilisation effect of the tax and benefit system on household income and consumption. The macroeconomic approach tries to capture the *total* stabilisation effect by considering also *indirect* effects from behavioural responses and macroeconomic feedback effects, which appear to weigh on growth and thereby reduce the degree of stabilisation ([54]).

([46]) McKay and Reis (2016a, b).
([47]) Dolls et al. (2012).
([48]) European Commission (2017a).
([49]) Barrell and Pina (2004), Barrell et al. (2002).
([50]) van den Noord (2000), in 't Veld et al. (2013).
([51]) Brunila et al. (2003).
([52]) Buti et al. (2002), Tödter and Scharnagl (2004), Wijkander and Roeger (2002).
([53]) Cohen and Follette (2000), McKay and Reis (2016a).
([54]) For instance, higher social transfers or taxes can weaken incentives to work and to invest in skills and increase unemployment (Conesa and Krueger 2006). In addition, high debt can weigh on growth (Chudik et al. 2017) and/or expose the economies to risk of deeper recessions (Jorda et al. 2016), while fiscal policy can also mitigate skill degradation in a depressed economy (DeLong and Summers 2012).

- ***Degree of progressivity*** *(micro- and macro-based approach)*: The degree of labour tax progressivity is an important factor affecting the smoothing capacity of automatic stabilisers. The stabilising effect of taxes will be greater the higher the tax rates applied and the more progressive the income tax schedule.
- ***Share of liquidity (un-)constrained households*** *(micro- and macro-based approach)*: Liquidity-constrained households cannot save or borrow against future income variations, and therefore cannot smooth their consumption over the cycle. As a consequence, the effectiveness of automatic stabilisers will be higher in economies with a larger share of liquidity-constrained households.
- ***Nature of shocks*** *(macro-based approach)*: Automatic stabilisers are generally found to be relatively powerful in the event of shocks to private consumption, but less so in the case of shocks to private investment and exports. For supply side shocks, the effectiveness of automatic stabilisers is considerably reduced ([55]).

Choice of the counterfactual benchmark scenario in macroeconomic models *(macro-based approach)*: The choice of the counterfactual benchmark scenario against which the functioning of automatic stabilisers is compared in macroeconomic models matters for the size of automatic stabilisers ([56]). If the benchmark scenario is defined as a budget where expenditure and revenues are fixed in levels, changes in the level of taxation and unemployment benefits are seen as automatically stabilising. Since unemployment benefits represent a relatively small share of total public spending, the bulk of stabilisation is associated with the revenue side of the budget. On the other hand, if the benchmark budget is defined as one where revenue and expenditure are constant as a share of GDP, automatic stabilisation mainly stems from progressive taxation and the size of government, particularly from the fact that the bulk of government expenditure does not respond to cyclical fluctuations.

4.3. CONCLUSIONS

This chapter shows that automatic stabilisers can play an important role in reducing business cycle fluctuations. A review of the literature shows that the tax and benefit system absorbs around 30-50% of the loss of household disposable income and up to 30% of GDP in the EU on average. However, sizeable differences exist across Member States. Overall, automatic stabilisers appear larger in the EU than in the US.

([55]) Brunila et al. (2003).
([56]) in 't Veld et al. (2013).

Table I.4.1: **Size of automatic stabilisers – overview of the literature**

Study	Approach	Type of shock and sample	Benchmark	Variable	Size of automatic stabilisation (percentage smoothing)
Cohen and Follette (2000)	Macro	Demand shock US	Fixed level of revenues	Output	10%
van den Noord (2000)	Macro	Combination of shocks over the 1990s 19 OECD countries	Fixed ratios of revenues and expenditure	Output	25-30%
Buti et al. (2002)	Macro	Combination of demand and supply shocks	Fixed ratio of fiscal balance	Output	Belgium: 14% France: 22%
Barrell et al. (2002)	Macro	All 1993q1 shocks Euro area	Fixed levels of revenues and expenditure	Output	9%
Brunila et al. (2003)	Macro	Consumption and investment shock EU	Fixed level of fiscal balance	Output	Consumption shock: 20-30% Private investment shock: 3-10%
Barrell and Pina (2004)	Macro	All 1993q1 shocks Euro area	Fixed levels of revenue and expenditure	Output	11% on average
Tödter and Scharnagl (2004)	Macro	Consumption and investment shock Germany	Fixed level of fiscal balance	Output	Consumption shock: 18-26% Investment shock: 10-15%
Dolls et al. (2012)	Micro	Income and unemployment shock EU	/	Disposable income Demand	Income shock: disposable income: 38%; demand: 4-22% Unemployment shock: disposable income: 46%; demand: 13-30%
in 't Veld et al. (2013)	Macro	Combination of shocks to consumption, export demand and risk premia (2009 shocks) Euro area	Fixed levels of revenues and expenditure Fixed ratios of revenues and expenditure	Output	Fixed levels of revenue and expenditure: 13% Fixed ratios of revenues and expenditure: 27%
McKay and Reis (2016b)	Macro	US	Fixed levels of revenues and expenditure	Output Consumption	Output volatility: close to 0 Consumption volatility: -12.3%
European Commission (2017a)	Micro/ macro	Micro: Income shock Macro: Combination of productivity and export shocks	Fixed levels of revenues and expenditure	Disposable income Output	Disposable income (micro): 33% Output (macro): around 6%

5. ROLE OF PUBLIC FINANCES IN THE TRANSITION TO A CLIMATE-NEUTRAL AND HEALTHY PLANET

5.1. INTRODUCTION

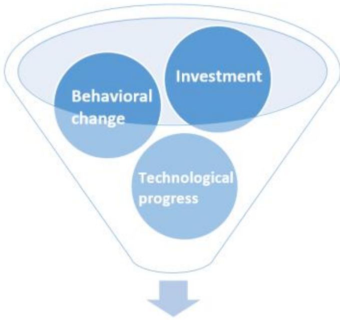
With the European Green Deal, the Commission stated the ambition for the EU to lead the transition to a 'climate-neutral and healthy planet' ([57]). This includes an endorsement of the objective of climate neutrality by 2050, which will be enshrined into a European Climate Law. The speed of the carbon emission reductions is to be stepped up. By autumn 2020, the Commission will present a plan to increase the EU's greenhouse gas emission reductions target for 2030 from the current 40% to at least 50% and towards 55% in a responsible way. A high level of ambition in other environmental domains (e.g. biodiversity, air pollution, circular economy, and plastics) will be translated into further policy measures. Addressing this challenge will require investments and behavioural change by citizens, firms and institutions. The transition could be around the globe, facilitated by technological progress. The global nature of the externality requires coordinated action and international governance systems ([58]).

This chapter provides an overview of the fiscal policy dimension of the European Green Deal. Section 5.2. presents tools for public finances to support the climate and environmental transition. Section 5.3. discusses implications and challenges of the transition for the EU fiscal governance framework. Finally, Section 5.4. concludes.

5.2. TOOLS FOR PUBLIC FINANCES TO SUPPORT THE CLIMATE AND ENVIRONMENTAL TRANSITION

Public finances will be subject to significant challenges on account of climate change but, equally, will play a central role in the climate transition. On the one hand, the transition may imply higher public expenditure. Risks to the sustainability of public finances may increase as a result of the projected surge in losses resulting from extreme weather events ([59]), while the climate transition will require substantial public investments. Social and compensatory policies will also be needed to help citizens, regions and industries that will be particularly negatively affected. Moreover, climate adaptation investments will weigh on government finances in the short and medium run, while reducing risks and costs of climate change in the longer run. On the other hand, transition policies may raise revenues and reduce expenditure. Carbon pricing instruments such as higher carbon taxes, increased use of emissions trading schemes and reductions in harmful subsidies, may raise revenues and reduce expenditures by phasing out fossil fuel subsidies.

Graph I.5.1: **Schematic overview of the transition to a climate-neutral and healthy planet**



Carbon pricing is an essential element of the policies to reduce greenhouse gas emissions as distorted price signals, together with economic growth, are at the origin of the harmful rapid rise of emissions ([60]).

([57]) European Commission (2019c).

([58]) Nordhaus (2019) discusses the economics of climate change, addressing the climate-change externality – its sources, its potential impacts, and the policy tools that are available.

([59]) The ecological, social and economic impacts of climate change are beginning to be visible. According to Munich Re NatCatSERVICE, the number of major natural disasters in the world is increasing, notably due to weather phenomena. Weather-related disasters globally caused a record economic damage of nearly EUR 290 billion in 2017, roughly a doubling of the average of the last ten years. This trend is set to continue and may accelerate if certain tipping points trigger major irreversible processes such as the rapid melting of ice caps and changes in ocean circulation.

([60]) The social costs of GHG emissions are not fully reflected in the market price. Howard and Sterner (2017) explain that the social cost of carbon (SCC) is one of the primary tools that has been used for calibrating the socially optimal

5.2.1. Carbon pricing

Internalising environmental costs using carbon pricing is widely considered a flexible and efficient way to achieve emission reduction goals ([61]). For example, according to an IMF study ([62]), efficient fossil fuel pricing would lower global carbon emissions by 28%, reduce deaths linked to air pollution, and increase government revenue by 3.8% GDP. If these revenues are used to reduce more distortionary taxes or to increase productive investment, carbon taxation could actually lead to higher growth and employment ([63]). Even so, carbon pricing programmes in most countries are fairly modest, while harmful subsidies remain large ([64]).

5.2.2. Green budgeting practices

The greening of Member States' budgets is an important tool to address the challenges of climate mitigation and environmental protection. With the budgets of Member States representing close to half of their GDP (on average), budgetary policies must play a crucial role in the promotion of the climate and ecological transitions. By establishing connections between budgetary tools and environmental and climate change goals, green budgeting can contribute to a mainstreaming of green budgetary policies and processes.

Encompassing a wide array of elements, the concept of 'green budgeting' is understood differently across policy makers and practitioners. The OECD (2018) provides a broad definition: "Green budgeting means using the tools of budgetary policy-making to help achieve environmental goals. This includes evaluating the environmental impact of budgetary or fiscal policies and assessing their coherence towards the delivery of national and international commitments. Green budgeting can also contribute to informed, evidence-based debate and discussion on sustainable growth". Within this, a wide range of practices, which are quite different in nature and level of ambition, are considered.

In a nutshell, green budgeting means gauging how environmentally-friendly a budget is. Within the array of elements considered, a more focused definition of green budgeting relates to addressing the fundamental question: '*How green is a country's fiscal policy?*'. This implies establishing a practice of presenting green measures in national budgetary documents, as well as identifying harmful expenditures or harmful features of the tax system.

An initial review of practices conducted by the Commission points to very limited use of green budgeting in the EU. Commission's staff screened budgetary documents published over the last few years in order to identify whether and how the green impact of expenditure items is highlighted (e.g. dedicated section, tables, annexes). By and large, the review points to a very limited use of green budgeting practices in the EU with information found only for France, Ireland, Italy and Sweden. For a more comprehensive analysis, information was supplemented by practices in use outside the EU (Mexico, New Zealand and Norway).

This first review of practices across Member States points to two main presentational approaches of green budgeting. The more common one consists of tagging those components of the budget (programmes or actions of programmes) that explicitly contribute to climate and environmental objectives. An alternative approach assesses the 'greenness' of the entire budget, distinguishing items that are favourable, unfavourable or neutral in terms of their contribution to green objectives.

policy response. The SCC is estimated using integrated assessment models (IAMs), which capture the various steps in the climate and economic processes that translate a marginal unit of CO2 emissions into a measurement of economic damage.

([61]) IMF (2019) analyses the global use of carbon taxes and suggest that it is the single most powerful way to address the climate crisis. They stress that to make carbon taxes politically feasible and economically efficient, governments need to choose how to use the new revenue. Options include cutting other kinds of taxes, supporting vulnerable households and communities, increasing investment in green energy, or simply returning the money to people as a dividend.

([62]) Coady et al. (2019).

([63]) Note that, if effective in reducing emissions, the revenues from carbon prices should only be of a temporary nature as the tax base should shrink in line with the objective of carbon neutrality by 2050. Abolishing harmful (carbon) subsidies would, however, lead to permanent savings.

([64]) In Member States energy and transport taxes have remained fairly constant as share of GDP between 1999 and 2018 at about 2.5% on average (Graph II.4.2).

Overall, the evidence gathered shows a wide variety of practices (Table I.5.1**)**. First of all, the scope of budgetary items differs quite widely, with some Member States looking at the entirety of the budget (France) and others only covering allocated expenditures (Ireland, Italy). The coverage might also differ with regards to the type of expenditure, with some exclusively focusing on climate-related expenditure (e.g. Ireland, Sweden) and others looking more broadly at environmental/ecological expenditure (e.g. France, Italy, Mexico). Even when Member States focus on the same type of expenditure, underlying definitions differ, leading to aggregates that are not comparable. For example, Italy examines expenditure items following the Environmental Protection Expenditure Accounts (EPEA) approach, as applied in COFOG. This includes those programmes featuring environment as a primary goal. France, in contrast, includes all expenditures that contribute in any way to environmental goals (e.g. railways). At times, a scoring of items based on the environmental content is applied (France). In some cases, presenting environmental considerations is part of farther-reaching efforts to create 'green' budgetary frameworks (Ireland, Norway, Sweden). Interestingly, in Italy and New Zealand environmental considerations are included in the more overarching goal of 'well-being'.

Table I.5.1: **Summary of green budgeting practices**

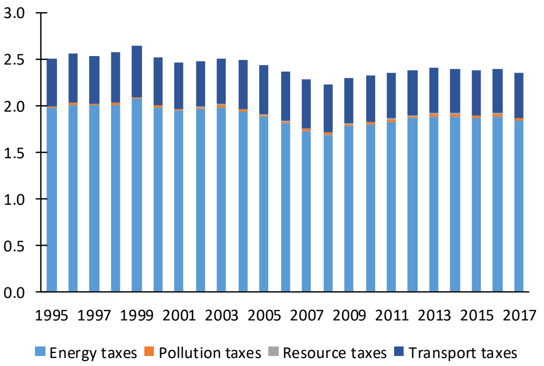
Country	Scope	Coverage	Definition	Link with long-term goals
France	Revenue + allocated expenditure	Climate + environment (also harmful)	All contribution considered	No
Italy	Allocated + executed expenditure	Environment	ESTAT environmental protection	No
Ireland	Allocated expenditure	Climate	Clear objective	No
Sweden	Allocated expenditure	Climate	Clear objective	Yes
Mexico	Allocated + executed expenditure	Environment + climate	Clear objective	No
Norway	Allocated expenditure	Environment + climate	Clear objective	Yes
New Zealand	Allocated expenditure	Environment	Clear objective	No

The evidence points to relatively small amounts of spending dedicated explicitly to environment and climate objectives. Expenditure favourable to the environment (including climate) as a percentage of GDP amounts to: less than 0.1% of GDP in Sweden; around 0.1% in Italy and Norway; around 0.3% in Mexico and New Zealand; 0.5% in Ireland; and 1.5% of GDP of in France. These small amounts may reflect quite conservative approaches to identifying what is 'green' within a budget, particularly in Member States that have only recently embarked on this process (e.g. Ireland).

This variety of approaches partly results from a lack of consensus on the way to define and identify green expenditure items. In contrast, the definition and understanding of environmental revenues rely on a broad-based and longstanding methodological consensus. The challenges associated with defining environmental-related expenditure mainly stem from three factors. First is the multi-dimensional nature of environmental objectives, which encompass a variety of goals, including climate action, pollution reduction and biodiversity. As a result, a measure favourable to a specific goal could turn to be unfavourable to another goal. Second is the different shades of green: Carney (2019) suggests that it may be hard to classify measures in a binary way (green or brown) as they can contribute to the environment with various degrees. This gives rise to the question of whether to include secondary and indirect impacts, as well as direct impacts, and if so how to appropriately weigh or scale the allocated expenditure amount. Finally, the long-term dimension of environmental challenges implies that the impacts of some measures will only be properly understood in the long term, possibly following an impact-assessment analysis.

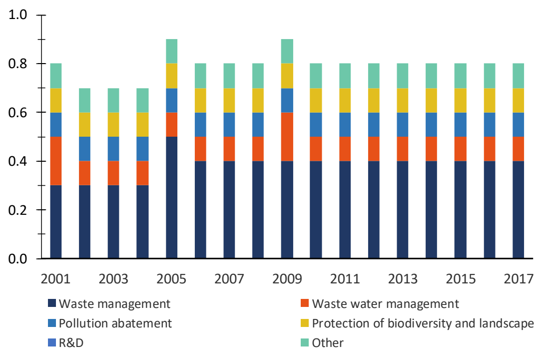
At EU levels, two emerging initiatives are worth considering. In May 2018, the Commission proposed a taxonomy for sustainable activities, which defines general principles to determine whether an economic activity is environmentally sustainable. The principles take into account the multi-dimension of the environmental objective and should allow distinguishing activities that contribute to these objectives. At the same time, in the context of the Commission's proposal for the EU multiannual financial framework 2021-2027, an intensive work to streamline and improve the climate tracking methodology, based on the OECD Rio marker, has been carried out. This methodology assigns a weight (0%, 40% or 100%) to expenditure items based on their climate content.

Graph I.5.2: **Environmental tax revenues in the EU (1995-2017, % of GDP)**



Note: Resource tax revenues (% of GDP) are too small to be visible in this graph.
Source: Eurostat.

Graph I.5.3: **Environmental protection expenditure (2001-2017, % of GDP)**



Source: Eurostat, COFOG database.

Available databases report scarce information on environmental revenue (mostly taxes) and environmental protection expenditure. In particular, Eurostat provides data for all Member States on different types of environmental taxes (energy, transport, pollution and resources) since 1995. The Eurostat COFOG database on government expenditure by function also includes data on environmental protection expenditure ([65]), with the expenditure item only included if environmental protection is its primary goal (e.g. railways are excluded). In 2017, environmental tax revenue and environmental protection expenditure in the EU were around 2.4% of GDP and 0.8% of GDP, respectively (Graphs II.4.2 and II.4.3).

5.3. EU FISCAL GOVERNANCE AND SURVEILLANCE INSTRUMENTS

At EU level, governance for the Energy Union and Climate Action has been established for steering the delivery of the 2030 European climate and energy targets. It came into force at the end of 2018. Under this framework, all Member States are requested to develop ten-year National Energy and Climate Plans (NECPs), in which they define their national objectives and targets along the five dimensions of the Energy Union Strategy, including the associated policy measures to reach them. The first NECPs have been published for the period 2021-2030. Progress reporting and reviews of the plans are expected at regular intervals. Member States are requested to assess the macroeconomic and social impacts of the policies and measures that they will promote to achieve their national objectives and targets. Coordination at national and EU level across different fora will be important to ensure consistency of NECPs with budgetary priorities and the EU fiscal framework.

At present, there are no specific provisions regarding climate-change-related costs and risks in the EU's fiscal framework. Given the impact that climate and transition risks may have on fiscal outcomes, a conceptual analytical framework could help in identifying the main links and possible trade-offs involved. For instance, as fiscal sustainability risks and investment needs increase, trade-offs may arise between catering for higher investment needs on the one hand and anticipating future costs by raising saving on the other.

Climate change and climate change policies affect public debt sustainability risks. As the frequency and intensity of extreme weather events rises worldwide, they may increasingly lead to large economic losses that are shared by the public and private sectors. Fiscal policy responses to climate change-related extreme weather events tend to increase general government deficits and debts, often beyond what is anticipated in

([65]) Note that environmental protection expenditure according to the COFOG classification does not cover climate transition expenditure on energy, transport and housing.

budgetary documents. At the same time, existing empirical evidence shows heterogeneity across the EU, with some Member States being less directly exposed than others. Climate risks are generally not considered in the medium and long-term budgetary risk assessments because they have historically been limited in size in most cases. The Debt Sustainability Monitor 2019 discusses how the climate change impacts could be incorporated in debt sustainability analysis.

Debt sustainability may be affected by climate change through the direct physical impact of extreme weather events and the gradual transformation of the environment. The Debt Sustainability Monitor 2019 discusses how the climate change impacts could be incorporated in debt sustainability analysis. Relief and reconstruction efforts after extreme weather events (heatwaves, draughts, floods, forest and wildfires, etc.) may increase government expenditure ([66]). In addition to spending to replace damaged public infrastructure, fiscal costs may cover compensation of private sector losses as well as the materialisation of contingent liabilities linked to the financial sector in case of major disasters. If production capacity is affected, it may result in a temporary or permanent economic slowdown, lower revenues and increased social protection expenditure.

The share of losses that will be absorbed by the public sector is uncertain and may differ depending on the severity of the event ([67]). Economic and financial losses from climate-related events are distributed across different risk-owners ([68]): governments (at local, central and at European level); the (re)insurance industry ([69]); businesses and citizens; and (international) investors in capital markets, either by taking explicit climate risks (e.g. cat bonds, insurance-linked securities, contingent credit, weather derivatives) or through private sector defaults. The distribution of losses across these risk-owners is organised differently across Member States, and is often ad hoc and not explicit. While the use of sovereign risk-sharing instruments has increased in recent years, it has mostly developed outside the European Union. Such instruments can take a range of forms, from self-insurance funds, contingent credit lines, ‘hurricane clauses’ in debt instruments to parametric insurance through a regional pooling mechanism ([70]).

Another challenge is the high degree of uncertainty about future economic impacts as reflected in wide range of model projections. Howard and Sterner (2017) find a wide range of potential average damage estimates (from 1.9% to 17.3% of GDP) for a 3 degrees increase in global average surface temperature (compared to the pre-industrial period). According to their preferred specification, non-catastrophic damages are likely to be between 7% and 8% of GDP for a 3 degree global temperature increase. This compares to lower estimates from, for example, the Nordhaus DICE model, which predicts a 2.4% GDP loss. The impact is likely to be heterogeneous across regions and sectors, with greater impact for regions with higher initial temperature. In Europe, Member States in the north are projected to have negligible or –in some models– even beneficial effects, while climate damage will be high in the south ([71]).

Beyond the direct physical impact, climate change adaptation and mitigation can have substantial fiscal costs. Estimates of the total costs of climate commitments for the economy and government finances are made in several Member States’ NECPs. Where estimates exist, uncertainty is very large, especially in the medium and long run.

([66]) Benson and Clay (2004), Heipertz and Nickel (2008), Lis and Nickel (2010), IMF (2016).
([67]) Better risk pricing and better information on potential losses induced by insurance may also stimulate adaptation investment and raise resilience.
([68]) Risk allocation may also be affected by the litigation claims of risk bearers to companies and governments allegedly responsible for climate change losses (e.g. energy producers for past emissions, or local governments for neglect as to adaptation investment needs).
([69]) In the EU only 35% of losses caused by climate-related events are insured, with a high degree of variation across Member States. Heat waves, drought and forest fires are the least insured and show increasingly sizeable losses due to climate change. The European Insurance and Occupational Pensions Authority (EIOPA) has warned that insurability and affordability is likely to become an increasing concern from the supervisory and consumer protection points of view.
([70]) If risks are not diversified internationally (through reinsurance and other instruments), major disasters may also have domestic balance sheet effects, thus affecting the financial sector and interacting with sovereign risks.
([71]) IMF 2016.

Commission services are exploring ways to integrate climate change impacts into their debt sustainability analysis framework. Taking account of the uncertain and contingent nature of many of the impacts, climate-related stress tests can be designed to country-specific risk exposures. Alternative customized policy scenarios can be built to illustrate the impact of the gradual transformation of the environment on debt sustainability, under different paths for GHG emissions and climate impacts. The design of such stress tests and alternative scenarios will prove challenging in practice, given economic modelling limitations already discussed, and important data gaps.

5.4. CONCLUSIONS

Commission President Ursula von der Leyen has stated the EU's ambition to lead the transition to a 'climate-neutral and healthy planet'.

The transition has implications for fiscal policy. On the one hand, the mitigation and adaptation investments and the social policies needed to help the citizens and regions most affected by the transition imply higher public expenditure. On the other hand, carbon-pricing instruments to address distorted price signals may raise revenues and cut expenditure by phasing out fossil fuel subsidies.

The Commission is exploring ways to integrate the risks associated with climate change and the transition to a carbon-neutral economy in the fiscal governance and surveillance framework. Despite a high degree of uncertainty about future economic impacts and other methodological challenges, better integration of the transition and physical risks into the Commission's debt sustainability analysis framework seems a promising option. More at large, a conceptual analytical framework identifying the main links and possible trade-offs would help better understanding the different roles fiscal policy can play for the transition.

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Table I.A.1: **Overview EDP steps – euro area Member States**

Steps in EDP procedure	Treaty Art.	Member State																
		IE	FR	ES	LV	MT	LT	BE	DE	IT	NL	AT	PT	SI	SK	CY	FI	MT
Starting phase																		
Commission adopts EDP-report = start of the procedure	126(3)	18.02.2009	18.02.2009	18.02.2009	18.02.2009	13.05.2009	13.05.2009	07.10.2009	07.10.2009	07.10.2009	07.10.2009	07.10.2009	07.10.2009	07.10.2009	07.10.2009	12.05.2010	12.05.2010	21.05.2013
Economic and Financial Committee adopts opinion	126(4)	27.02.2009	27.02.2009	27.02.2009	27.02.2009	29.05.2009	29.05.2009	27.10.2009	27.10.2009	27.10.2009	27.10.2009	27.10.2009	27.10.2009	27.10.2009	27.10.2009	27.05.2010	27.05.2010	21.06.2013
Commission adopts:																		
opinion on existence of excessive deficit	126(5)																	
recommendation for Council decision on existence of excessive deficit	126(6)	24.03.2009	24.03.2009	24.03.2009	02.07.2009	24.06.2009	24.06.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	11.11.2009	15.06.2010	15.06.2010	29.05.2013
recommendation for Council recommendation to end this situation	126(7)																	
Council adopts:																		
decision on existence of excessive deficit	126(6)	27.04.2009	27.04.2009	27.04.2009	07.07.2009	07.07.2009	07.07.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	02.12.2009	13.07.2010	13.07.2010	21.06.2013
recommendation to end this situation	126(7)																	
deadline for correction of excessive deficit		***2013***	***2012***	***2012***	***2012***	***2010***	***2011***	***2012***	***2013***	***2012***	***2013***	***2013***	***2013***	***2013***	***2013***	***2012***	***2011***	***2014***
Follow-up																		
Commission adopts communication on action taken					27.01.2010			15.06.2010	15.06.2010	15.06.2010	15.06.2010	15.06.2010	15.06.2010	15.06.2010	15.06.2010	27.01.2011	27.01.2011	15.11.2013
Commission adopts recommendation for NEW Council recommendation to end situation of excessive deficit	126(7)	11.11.2009	11.11.2009	11.11.2009		27.01.2010	27.01.2010				29.05.2013		27.09.2012					
Council adopts recommendation for NEW Council recommendation to end situation of excessive deficit	126(7)	02.12.2009	02.12.2009	02.12.2009		16.02.2010	16.02.2010				21.06.2013		09.10.2012					
new deadline for correction of excessive deficit		***2014***	***2013***	***2013***		***2011***	***2012***				***2014***		***2014***					
Commission adopts communication on action taken		15.06.2010	15.06.2010	15.06.2010		06.01.2011	21.09.2010	11.01.2012			15.11.2013					11.01.2012		
Commission adopts recommendation for Council decision establishing inadequate action	126(8)							29.05.2013										
Council adopts decision establishing inadequate action	126(8)							21.06.2013										
Commission adopts recommendation for a Council decision to give notice	126(9)							29.05.2013										
Council adopts decision to give notice	126(9)							21.06.2013										
Commission adopts recommendation for NEW Council recommendation to end situation of excessive deficit	126(7)	03.12.2010	29.05.2013	06.07.2012									29.05.2013	29.05.2013		07.05.2013		
Council adopts recommendation for NEW Council recommendation to end situation of excessive deficit	126(7)	07.12.2010	21.06.2013	10.07.2012									21.06.2013	21.06.2013		16.05.2013		
new deadline for correction of excessive deficit		***2015***	***2015***	***2014***				***2013***					***2015***	***2015***		***2016***		
Commission adopts communication on action taken		24.08.2011	15.11.2013	14.11.2012				15.11.2013						15.11.2013		06.09.2013*		
Commission adopts recommendation for NEW Council recommendation to end situation of excessive deficit	126(7)		27.02.2015	29.05.2013														
Council adopts recommendation for NEW Council recommendation to end situation of excessive deficit	126(7)		10.03.2015	21.06.2013														
new deadline for correction of excessive deficit			***2017***	***2016***														
Commission adopts communication on action taken			01.07.2015	15.11.2013														
Commission adopts recommendation for Council decision establishing inadequate action	126(8)			07.07.2016									07.07.2016					
Council adopts decision establishing inadequate action	126(8)			12.07.2016									12.07.2016					
Commission adopts recommendation for Council implementing decision imposing a fine for failure to take effective action	126(8)			27.07.2016									27.07.2016					
Commission adopts recommendation for Council decision to give notice	126(9)			27.07.2016									27.07.2016					
Council adopts decision to give notice	126(9)			08.08.2016									08.08.2016					
new deadline for correction of excessive deficit				***2018***									***2016***					
Council adopts implementing decision on imposing a fine for failure to take effective action	126(8)			08.08.2016									08.08.2016					
Commission adopts communication on action taken				16.11.2016									16.11.2016					
Commission adopts proposal for Council opinion on Economic Partnership Programme													16.11.2016					
Abrogation																		
Commission adopts recommendation for Council decision abrogating existence of excessive deficit	126(12)	18.05.2016	23.05.2018	05.06.2019	29.05.2013	14.11.2012	29.05.2013	02.06.2014	30.05.2012	29.05.2013	02.06.2014	02.06.2014	22.05.2017	18.05.2016	02.06.2014	18.05.2016	29.06.2011	12.05.2015
Council adopts decision abrogating existence of excessive deficit	126(12)	17.06.2016	22.06.2018	14.06.2019	21.06.2013	04.12.2012	21.06.2013	20.06.2014	22.06.2012	21.06.2013	20.06.2014	20.06.2014	16.06.2017	17.06.2016	20.06.2014	17.06.2016	12.07.2011	19.06.2015

Note: * In line with Regulation (EU) No 472/2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability (two-pack) the assessment of effective action is carried out in the context of the programme surveillance.

Table I.A.2: **Overview EDP steps – non-euro area Member States and UK**

Steps in EDP procedure	Treaty Art.	Member State							UK
		HU	PL	RO	CZ	BG	DK	HR	
Starting phase									
Commission adopts EDP-report = start of the procedure	126(3)	12.05.2004	13.05.2009	13.05.2009	07.10.2009	12.05.2010	12.05.2010	15.11.2013	11.06.2008
Economic and Financial Committee adopts opinion	126(4)	24.05.2004	29.05.2009	29.05.2009	27.10.2009	27.05.2010	27.05.2010	29.11.2013	25.06.2008
Commission adopts:									
opinion on existence of excessive deficit	126(5)								
recommendation for Council decision on existence of excessive deficit recommendation for Council recommendation to end this situation	126(6) 126(7)	24.06.2004	24.06.2009	24.06.2009	11.11.2009	06.07.2010	15.06.2010	10.12.2013	02.07.2008
Council adopts:									
decision on existence of excessive deficit recommendation to end this situation	126(6) 126(7)	05.07.2004	07.07.2009	07.07.2009	02.12.2009	13.07.2010	13.07.2010	21.01.2014	08.07.2008
deadline for correction of excessive deficit		***2008***	***2012***	***2011***	***2013***	***2011***	***2013***	***2016***	***fin. year 2009/10***
Follow-up									
Commission adopts communication on action taken			03.02.2010		15.06.2010	27.01.2011	27.01.2011	02.06.2014	
Commission adopts recommendations for Council decision establishing inadequate action	126(8)	22.12.2004							24.03.2009
Council adopts decision establishing inadequate action	126(8)	18.01.2005							27.04.2009
Commission adopts recommendation for NEW Council recommendation to end excessive deficit situation	126(7)	16.02.2005		08.02.2010					24.03.2009
Council adopts NEW recommendation to end excessive deficit situation	126(7)	08.03.2005		16.02.2010					27.04.2009
new deadline for correction of excessive deficit		***2008***		***2012***					***fin. year 2013/14***
Commission adopts communication on action taken		13.07.2005	11.01.2012	21.09.2010					
Commission adopts recommendations for Council decision establishing inadequate action	126(8)	20.10.2005							
Council adopts decision establishing inadequate action	126(8)	08.11.2005							
Commission adopts recommendation for NEW Council recommendation to end excessive deficit situation	126(7)	26.09.2006							11.11.2009
Council adopts NEW recommendation to end excessive deficit situation	126(7)	10.10.2006							02.12.2009
new deadline for correction of excessive deficit		***2009***							***fin. year 2014/15***
Commission adopts communication on action taken		13.06.2007							06.07.2010
Commission adopts recommendations for Council decision establishing inadequate action	126(8)								12.05.2015
Council adopts decision establishing inadequate action	126(8)								19.06.2015
Commission adopts recommendation for NEW Council recommendation to end excessive deficit situation	126(7)	24.06.2009	29.05.2013						12.05.2015
Council adopts NEW recommendation to end excessive deficit situation	126(7)	07.07.2009	21.06.2013						19.06.2015
new deadline for correction of excessive deficit		***2011***	***2014***						***fin. year 2016/17***
Commission adopts communication on action taken		27.01.2010							16.11.2015
Commission adopts recommendations for Council decision establishing inadequate action	126(8)	11.01.2012	15.11.2013						
Council adopts decision establishing inadequate action	126(8)	24.01.2012	10.12.2013						
Commission adopts recommendation for NEW Council recommendation to end excessive deficit situation	126(7)	06.03.2012	15.11.2013						
Council adopts NEW recommendation to end excessive deficit situation	126(7)	13.03.2012	10.12.2013						
new deadline for correction of excessive deficit		***2012***	***2015***						
Commission adopts communication on action taken		30.05.2012	02.06.2014						
Abrogation									
Commission adopts recommendation for Council decision abrogating existence of excessive deficit	126(12)	29.05.2013	12.05.2015	29.05.2013	02.06.2014	30.05.2012	02.06.2014	22.05.2017	22.11.2017
Council adopts decision abrogating existence of excessive deficit	126(12)	21.06.2013	19.06.2015	21.06.2013	20.06.2014	22.06.2012	20.06.2014	16.06.2017	04.12.2017

Table I.A.3: **Overview EDP steps – Greece**

Steps in EDP procedure	Treaty Art.	Greece
Starting phase		
Commission adopts EDP-report = start of the procedure	126(3)	18.02.2009
Economic and Financial Committee adopts opinion	126(4)	27.02.2009
Commission adopts:		
opinion on existence of excessive deficit	126(5)	
recommendation for Council decision on existence of excessive deficit	126(6)	24.03.2009
recommendation for Council recommendation to end this situation	126(7)	
Council adopts:		
decision on existence of excessive deficit	126(6)	27.04.2009
recommendation to end this situation	126(7)	
deadline for correction of excessive deficit		***2010***
Follow-up		
Commission adopts recommendations for Council decision establishing inadequate action	126(8)	11.11.2009
Council adopts decision establishing inadequate action	126(8)	02.12.2009
Commission adopts Council recommendation for decision to give notice	126(9)	03.02.2010
Council decision to give notice	126(9)	16.02.2010
new deadline for correction of the excessive deficit		***2012***
Commission adopts communication on action taken		09.03.2010
Council adopts conclusions thereon		16.03.2010
Commission adopts recommendation for NEW Council decision to give notice	126(9)	04.05.2010
Council decision to give notice	126(9)	10.05.2010
new deadline for correction of the excessive deficit		***2014***
Follow-up - 1st review		
Commission adopts communication on action taken		19.08.2010
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	19.08.2010
Council decision amending the Council decision to give notice	126(9)	07.09.2010
Follow-up - 2nd review		
Commission adopts communication on action taken		09.12.2010
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	09.12.2010
Council decision amending the Council decision to give notice	126(9)	20.12.2010
Follow-up - 3rd review		
Commission adopts communication on action taken		24.02.2011
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	24.02.2011
Council decision amending the Council decision to give notice	126(9)	07.03.2011
Follow-up - 4th review		
Commission adopts communication on action taken		01.07.2011
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	05.07.2011
Council decision amending the Council decision to give notice	126(9)	12.07.2011
Follow-up - 5th review		
Commission adopts communication on action taken		26.10.2011
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	26.10.2011
Council decision amending the Council decision to give notice	126(9)	08.11.2011
Follow-up - Second Adjustment Programme		
Commission adopts communication on action taken		09.03.2012
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	09.03.2012
Council decision amending the Council decision to give notice	126(9)	13.03.2012
Follow-up - Second Adjustment Programme		
Commission adopts communication on action taken		30.11.2012
Commission adopts recommendation for Council decision amending the Council decision to give notice	126(9)	30.11.2012
Council decision amending the Council decision to give notice	126(9)	04.12.2012
new deadline for correction of the excessive deficit		***2016***
Follow-up - Third Adjustment Programme		
Council adopts decision to give notice	126(9)	20.08.2015
Abrogation		
Commission adopts recommendation for Council decision abrogating existence of excessive deficit	126(12)	12.07.2017
Council adopts decision abrogating existence of excessive deficit	126(12)	25.09.2017

Table I.A.4: **Overview SDP steps – Romania and Hungary**

Steps in SDP procedure	Treaty Art.	Romania	Romania (cont.)	Romania (cont.)	Hungary	Hungary (cont.)
Starting phase						
Commission adopts:						
recommendation with a view to giving warning on the existence of a significant observed deviation	121(4)	22.05.2017	23.05.2018	05.06.2019	23.05.2018	05.06.2019
recommendation for Council recommendation with a view to correcting the significant observed deviation	121(4)	22.05.2017	23.05.2018	05.06.2019	23.05.2018	05.06.2019
Council adopts recommendation with a view to correcting the significant observed deviation	121(4)	16.06.2017	22.06.2018	14.06.2019	22.06.2018	14.06.2019
deadline for report on action taken		***15.10.2017***	***15.10.2018***	***15.10.2019***	***15.10.2018***	***15.10.2019***
Follow-up						
Commission adopts:						
recommendation for Council decision on no effective action	121(4)	22.11.2017	21.11.2018	20.11.2019	21.11.2018	20.11.2019
recommendation for Council recommendation with a view to correcting the significant observed deviation	121(4)	22.11.2017	21.11.2018	20.11.2019	21.11.2018	20.11.2019
Council adopts:						
decision on no effective action	121(4)	05.12.2017	04.12.2018		04.12.2018	
recommendation with a view to correcting the significant observed deviation	121(4)	05.12.2017	04.12.2018		04.12.2018	
new deadline for report on action taken		***15.04.2018***	***15.04.2019***		***15.04.2019***	
Commission adopts:						
recommendation for Council decision on no effective action	121(4)	23.05.2018	05.06.2019		05.06.2019	
Council adopts:						
decision on no effective action	121(4)	22.06.2018	14.06.2019		14.06.2019	

Table I.A.5: **Overview of Council country-specific recommendations related to fiscal policy**

	Applicable provisions of the SGP (spring 2019)	Other relevant information	CSR on SGP	CSR on fiscal policy and fiscal governance	CSR on reducing the tax burden on labour and broadening tax bases	CSR on long-term sustainability of public finances, including pensions	CSR on fight against tax evasion, improve tax administration and tackle tax avoidance
BE	• Preventive arm • Debt benchmark	• MTO: 0% • Debt > 60%	Ensure that the nominal growth rate of net primary government expenditure does not exceed 1.6% in 2020, corresponding to an annual structural adjustment of 0.6% of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio.	Improve the composition and efficiency of public spending, in particular through spending reviews, and the coordination of fiscal policies by all levels of government to create room for public investment.			Continue reforms to ensure the fiscal sustainability of the long-term care and pension systems, including by limiting early exit possibilities from the labour market.
BG	Preventive arm	MTO: -1%					Improve tax collection through targeted measures in areas such as fuel and labour taxes.
CZ	Preventive arm	MTO: -1% in 2019 and -0.75% as of 2020				Improve long-term fiscal sustainability of the pension and health-care systems.	
DK	Preventive arm	MTO: -0.5%					
DE	Preventive arm	MTO: -0.5%	While respecting the medium-term budgetary objective, use fiscal and structural policies to achieve a sustained upward trend in private and public investment, in particular at regional and municipal level.		Shift taxes away from labour to sources less detrimental to inclusive and sustainable growth. Reduce disincentives to work more hours, including the high tax wedge, in particular for low-wage and second earners.	Take measures to safeguard the long-term sustainability of the pension system, while preserving adequacy.	
EE	Preventive arm	MTO: -0.5%	Ensure that the nominal growth rate of net primary government expenditure does not exceed 4.1% in 2020, corresponding to an annual structural adjustment of 0.6% of GDP.				
IE	Preventive arm	MTO: -0.5%	Achieve the medium-term budgetary objective in 2020. Use windfall gains to accelerate the reduction of the general government debt ratio.		Limit the scope and number of tax expenditures, and broaden the tax base.	Address the expected increase in age-related expenditure by making the healthcare system more cost-effective and by fully implementing pension reform plans.	Continue to address features of the tax system that may facilitate aggressive tax planning, and focus in particular on outbound payments.
EL	• Preventive arm([1]) • Transition period debt rule until 2019; debt benchmark as of 2020	• MTO: 0.25% as of 2020 • Debt > 60%	To avoid duplication with measures set out in the Economic Adjustment Programme, the CSR for Greece refers to achieving a sustainable economic recovery and tackling the excessive macroeconomic imbalances by continuing and completing reforms in line with the post-programme commitments given at the Eurogroup of 22 June 2018.				
ES	• Preventive arm • Transition period debt rule	• MTO: 0% • Debt > 60%	Ensure that the nominal growth rate of net primary government expenditure does not exceed 0,9% in 2020, corresponding to an annual structural adjustment of 0,65% of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio.	Take measures to strengthen the fiscal and public procurement frameworks at all levels of government.		Preserve the sustainability of the pension system.	
FR	• Preventive arm • Transition period debt rule	• MTO: -0.4% • Debt > 60%	Ensure that the nominal growth rate of net primary government expenditure does not exceed 1.2% in 2020, corresponding to an annual structural adjustment of 0.6% of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio.	Achieve expenditure savings and efficiency gains across all sub-sectors of the government, including by fully specifying and monitoring the implementation of the concrete measures needed in the context of Public Action 2022.	Continue to simplify the tax system, in particular by limiting the use of tax expenditures, further removing inefficient taxes and reducing taxes on production.	Reform the pension system to progressively unify the rules of the different pension regimes, with the view to enhance their fairness and sustainability.	
HR	• Preventive arm • Debt benchmark	• MTO:-1.75% in 2019 and -1% as of 2020 • Debt>60%		Reinforce the budgetary framework and monitoring of contingent liabilities at central and local level.			
IT	• Preventive arm • Debt benchmark	• MTO: 0% in 2019 and -0.5% as of 2020 • Debt >60%	Ensure a nominal reduction of net primary government expenditure of 0.1% in 2020, corresponding to an annual structural adjustment of 0.6% of GDP. Use windfall gains to accelerate the reduction of the general government debt ratio.		Shift taxation away from labour, including by reducing tax expenditure and reforming the outdated cadastral values.	Implement fully past pension reforms to reduce the share of old-age pensions in public spending and create space for other social and growth-enhancing spending.	Fight tax evasion, especially in the form of omitted invoicing, including by strengthening the compulsory use of e-payments including through lower legal thresholds for cash payments.
CY	• Preventive arm • Debt benchmark	• MTO: 0% • Debt >60%				Take measures to ensure that the National Health System becomes operational in 2020, as planned, while preserving its long-term sustainability.	Address features of the tax system that may facilitate aggressive tax planning by individuals and multinationals, in particular by means of outbound payments by multinationals.

([1]) Following the abrogation of the Excessive Deficit Procedure on 19 September 2017 and the completion of the ESM stability support programme on 20 August 2018, Greece became subject to the preventive arm of the Stability and Growth Pact and should preserve a sound fiscal position which ensures compliance with the primary surplus target set by Decision (EU) 2017/1226 on 30 June 2017 of 3.5% of GDP for 2018 and over the medium term. Since Greece was exempt from submitting Stability Programmes while it was under the programme, the Greek authorities did not establish a medium-term budgetary objective for 2018 and 2019.

(Continued on the next page)

Table (continued)

LV	Preventive arm	MTO: -1%	Ensure that the nominal growth rate of net primary government expenditure does not exceed 3,5%in 2020, corresponding to an annual structural adjustment of 0,5%of GDP.		Reduce taxation for low-income earners by shifting it to other sources, particularly capital and property, and by improving tax compliance.	Increase the accessibility, quality and cost-effectiveness of the healthcare system.	
LT	Preventive arm	MTO: -1%			Improve tax compliance and broaden the tax base to sources less detrimental to growth.		
LU	Preventive arm	MTO: -0.5% in 2019 and 0.5% as of 2020				Improve the long-term sustainability of the pension system, including by further limiting early retirement.	Address features of the tax system that may facilitate aggressive tax planning, in particular by means of outbound payments.
HU	• Preventive arm • Debt benchmark	• MTO: -1.5% in 2019 and -1% as of 2020 • Debt > 60%	Ensure compliance with the Council Recommendation of 14 June 2019 with a view to correcting the significant deviation from the adjustment path towards the medium-term budgetary objective.				Continue simplifying the tax system, while strengthening it against the risk of aggressive tax planning.
MT	Preventive arm	MTO: 0%				Ensure the fiscal sustainability of the healthcare and pension systems, including by restricting early retirement and adjusting the statutory retirement age in view of expected gains in life expectancy.	Address features of the tax system that may facilitate aggressive tax planning by individuals and multinationals, in particular by means of outbound payments.
NL	Preventive arm	MTO:-0.5%	While respecting the medium-term budgetary objective, use fiscal and structural policies to support an upward trend in investment.			Ensure that the second pillar of the pension system is more transparent, inter-generationally fairer and more resilient to shocks.	Address features of the tax system that may facilitate aggressive tax planning, in particular by means of outbound payments, notably by implementing the announced measures.
AT	• Preventive arm • Debt benchmark	• MTO:-0.5% • Debt>60%		Simplify and rationalise fiscal relations and responsibilities across layers of government and align financing and spending responsibilities.	Shift taxes away from labour to sources less detrimental to inclusive and sustainable growth.	Ensure the sustainability of the health, long-term care, and pension systems, including by adjusting the statutory retirement age in view of expected gains in life expectancy.	
PL	Preventive arm	MTO:-1%	Ensure that the nominal growth rate of net primary government expenditure does not exceed 4.4% in 2020, corresponding to an annual structural adjustment of 0.6% of GDP.	Take further steps to improve the efficiency of public spending, including by improving the budgetary process.		Ensure the adequacy of future pension benefits and the sustainability of the pension system by taking measures to increase the effective retirement age and by reforming the preferential pension schemes.	
PT	• Preventive arm • Transition period debt rule until 2019; debt benchmark as of 2020	• MTO: 0.25% in 2019 and 0% as of 2020 • Debt >60%	Achieve the medium-term budgetary objective in 2020, taking into account the allowance linked to unusual events for which a temporary deviation is granted. Use windfall gains to accelerate the reduction of the general government debt ratio.			Improve the quality of public finances by prioritising growth-enhancing spending while strengthening overall expenditure control, cost efficiency and adequate budgeting, with a focus in particular on a durable reduction of arrears in hospitals. Improve the financial sustainability of State-owned enterprises, while ensuring more timely, transparent and comprehensive monitoring.	
RO	Preventive arm	MTO:-1%	Ensure compliance with the Council Recommendation of 14 June 2019 with a view to correcting the significant deviation from the adjustment path towards the medium-term budgetary objective.	Ensure the full application of the fiscal framework.		Ensure the sustainability of the public pension system and the long-term viability of the second pillar pension funds.	Strengthen tax compliance and collection.
SI	• Preventive arm • Debt benchmark	• MTO: 0.25% in 2019 and -0.25% as of 2020 • Debt >60%	Achieve the medium-term budgetary objective in 2020.			Adopt and implement reforms in healthcare and long-term care that ensure quality, accessibility and long-term fiscal sustainability. Ensure the long-term sustainability and adequacy of the pension system, including by adjusting the statutory retirement age restricting early retirement and other forms of early exit from the labour market.	
SK	Preventive arm	MTO:-0.5% in 2019 and -1% as of 2020	Achieve the medium-term budgetary objective in 2020.			Safeguard the long-term sustainability of public finances, notably that of the healthcare and pension systems.	

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Table (continued)

FI	Preventive arm	MTO:-0.5%	Ensure that the nominal growth rate of net primary government expenditure does not exceed 1,9% in 2020, corresponding to an annual structural adjustment of 0,5%of GDP.			Improve the cost-effectiveness of and equal access to social and healthcare services.	
SE	Preventive arm	MTO:-1%					
UK	• Preventive arm • Transition period of the debt rule until 2019; debt benchmark as of 2020	• MTO:-0.8% in 2019 and -0.5% as of 2020 • Debt >60%	Ensure that the nominal growth rate of net primary government expenditure does not exceed 1.9% in 2020-2021, corresponding to an annual structural adjustment of 0.6% of GDP.				

Table I.A.6: **Overview of individual Commission opinions on the draft budgetary plans**

	Overall compliance of the draft budgetary plan with the Stability and Growth Pact		
Member States	**Overall conclusion of compliance based on the Commission 2019 autumn forecast**	**Compliance with the preventive arm requirements in 2019 and 2020**	**Progress with implementing the fiscal-structural part of the 2019 country-specific recommendations**
BE[(1),(2)]	Risk of non-compliance	2019: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective, prima facie non-compliance with the debt reduction benchmark; 2020: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective, prima facie non-compliance with the debt reduction benchmark.	Limited progress
ES[(3),(4)]	Risk of non-compliance	2019: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective, prima facie non-compliance with the transitional debt reduction benchmark; 2020: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective, prima facie non-compliance with the transitional debt reduction benchmark.	Limited progress
FR[(5)]	Risk of non-compliance	2019: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective, prima facie non-compliance with the transitional debt reduction benchmark; 2020: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective, prima facie non-compliance with the transitional debt reduction benchmark.	Limited progress
IT[(6)]	Risk of non-compliance	2019: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective, prima facie non-compliance with the debt reduction benchmark; 2020: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective, prima facie non-compliance with the debt reduction benchmark.	Some progress
PT[(7)]	Risk of non-compliance	2019: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective, compliance with the transitional debt reduction benchmark; 2020: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective, compliance with the debt reduction benchmark.	Limited progress
SI	Risk of non-compliance	2019: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective, compliance with the debt reduction benchmark; 2020: risk of some deviation from the adjustment path towards the medium-term budgetary objective in 2020; risk of a significant deviation from the adjustment path towards the medium-term budgetary objective based on 2019 and 2020 taken together, compliance with the debt reduction benchmark.	Limited progress
SK	Risk of non-compliance	2019: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective; 2020: risk of some deviation from the adjustment path towards the medium-term budgetary objective in 2020; risk of a significant deviation from the adjustment path towards the medium-term budgetary objective based on 2019 and 2020 taken together.	Limited progress
FI	Risk of non-compliance	2019: risk of some deviation from the adjustment path towards the medium-term budgetary objective; 2020: risk of a significant deviation from the adjustment path towards the medium-term budgetary objective.	Limited progress
EE	Broadly compliant	2019: risk of some deviation from the adjustment path towards the medium-term budgetary objective; 2020: risk of some deviation from the adjustment path towards the medium-term budgetary objective.	n.r.
LV	Broadly	2019: close to the medium-term budgetary objective adjusted for a temporary deviation allowance, while risk of a significant deviation	Some progress

(1) The Commission issued a report on 5 June 2019 in accordance with Article 126(3) TFEU in which it concluded that the analysis was not fully conclusive as to whether the debt criterion was or was not complied with.
(2) Draft budgetary plan submitted on a no-policy-change basis.
(3) Draft budgetary plan submitted on a no-policy-change basis.
(4) The EDP for Spain was abrogated on 14 June 2019 as the deficit had been brought below 3% of GDP in 2018 and it was projected to stay below 3% in 2019 and 2020. Spain is therefore subject to the preventive arm of the Stability and Growth Pact.
(5) The Commission issued a report on 5 June 2019 in accordance with Article 126(3) TFEU in which it concluded that the deficit and debt criteria as defined in the Treaty should be considered as complied with.
(6) The Commission issued a report on 5 June 2019 in accordance with Article 126(3) TFEU in which it concluded that the debt criterion should be considered as not complied with. Following Italy's updated fiscal plans of 1 July 2019 entailing a fiscal correction for 2019, the Commission issued a communication and sent a letter to the Italian authorities in July 2019, concluding that the package of measures adopted was sufficient not to open an EDP for Italy's lack of compliance with the debt criterion in 2018 at that stage.
(7) Draft budgetary plan submitted on a no-policy-change basis.

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Table (continued)

	compliant	from the expenditure benchmark requirement based on 2018 and 2019 taken together; 2020: close to the medium-term budgetary objective, while risk of significant deviation from the expenditure benchmark requirement	
DE	Compliant	2019: medium-term budgetary objective respected; 2020: medium-term budgetary objective respected.	Some progress
IE	Compliant	2019: compliance with the adjustment path towards the medium-term budgetary objective, compliance with the debt reduction benchmark; 2020: medium-term budgetary objective respected.	Limited progress
EL(8)	Compliant	2019: compliance with the transitional debt reduction benchmark; 2020: medium-term budgetary objective respected, compliance with the debt reduction benchmark.	n.r.(9)
CY(10)	Compliant	2019: medium-term budgetary objective respected, compliance with the debt reduction benchmark; 2020: medium-term budgetary objective respected, compliance with the debt reduction benchmark.	Limited progress
LT	Compliant	2019: close to the medium-term budgetary objective adjusted for a temporary deviation allowance, while risk of a significant deviation from the expenditure benchmark requirement; 2020: medium-term budgetary objective respected.	Some progress
LU	Compliant	2019: medium-term budgetary objective respected; 2020: medium-term budgetary objective respected.	Limited progress
MT	Compliant	2019: medium-term budgetary objective respected; 2020: medium-term budgetary objective respected.	Limited progress
NL	Compliant	2019: medium-term budgetary objective respected; 2020: medium-term budgetary objective respected.	Some progress
AT(11)	Compliant	2019: medium-term budgetary objective respected, compliance with the debt reduction benchmark; 2020: medium-term budgetary objective respected, compliance with the debt reduction benchmark.	Limited progress

(8) Following the abrogation of the Excessive Deficit Procedure on 19 September 2017 and the completion of the ESM stability support programme on 20 August 2018, Greece became subject to the preventive arm of the Stability and Growth Pact and should preserve a sound fiscal position which ensures compliance with the primary surplus target set by Decision (EU) 2017/1226 on 30 June 2017 of 3.5% of GDP for 2018 and over the medium term. Since Greece was exempt from submitting Stability Programmes while it was under the programme, the Greek authorities did not establish a medium-term budgetary objective for 2018 and 2019. Greece established its medium-term objective of 0.25% of GDP for 2020-2022 in the 2019 Stability Programme.

(9) The progress with implementation of the fiscal-structural part of the 2019 country-specific recommendations is monitored under the enhanced surveillance framework.

(10) The Commission issued a report on 5 June 2019 in accordance with Article 126(3) TFEU in which it concluded that further steps leading to a decision on the existence of an excessive deficit should not be taken.

(11) Draft budgetary plan submitted on a no-policy-change basis.