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2016 DRAFT BUDGETARY PLANS: OVERALL ASSESSMENT

Executive summary

This Communication summarises the Commission's assessment of the 2016 Draft Budgetary Plans (DBPs) submitted by 15 October, as required by the legislation, by sixteen euro area Member States (EA-16), excluding those under a macroeconomic adjustment programme and Portugal, the latter not having submitted a plan yet. In line with Regulation (EU) No 473/2013, the Commission has assessed these plans and the overall budgetary situation and fiscal stance in the euro area as a whole.

The overall assessment of the 2016 DBPs and the aggregate fiscal stance for the euro area can be summarised as follows:

1. The Member States' plans imply a continuing decrease in the aggregate headline budget deficit in the euro area in the context of a recovery that remains fragile and with a number of downside risks, mainly due to slowing external demand. After falling significantly from 2.4% of GDP in 2014 to reach 1.9% of GDP this year, the deficit is planned to decline further to 1.7% of GDP in 2016. Having peaked in 2014, the aggregate debt ratio in 2016 based on the DBPs is also planned to decrease slightly from the value of 91% estimated for the current year to just below 90% of GDP.
2. Compared to the medium-term plans formulated in the spring 2015 Stability Programmes, the planned deficit reduction in 2016 was revised downward and would be smaller, by 0.3 percentage points in the euro area.
3. The picture emerging from the DBPs is broadly confirmed by the Commission's autumn 2015 forecast. Real GDP growth is projected to strengthen from 1.6% this year to 1.8% in 2016, while the negative output gap is expected to narrow to 1% of potential GDP. Although starting from a slightly worse headline deficit estimate in the euro area for 2015 (2.0% of GDP), the Commission forecasts a slightly larger reduction in headline deficits than the DBPs in 2016 (by 0.3 percentage points instead of 0.2), to arrive at the same headline balance of -1.7% of GDP. The Commission projects that the aggregate debt-to-GDP ratio will decrease for the first time since the onset of the crisis to 91% in 2015 and fall further to 90% in 2016, which is broadly in line with the plans set out in the DBPs.
4. At the aggregate level, the Commission's forecast also indicates the continuation of a broadly neutral fiscal stance in 2016 in the euro area. This should be assessed against the twin objectives of long-term sustainability of public finances and short-term macroeconomic stabilisation, namely the need to ensure a shift from external to domestic sources of growth. Macroeconomic policy instruments are constrained at the current juncture, with nominal interest rates already almost at the zero limit in a very low inflation environment, placing further emphasis upon the importance of fiscal policy. In these terms, the expected neutral aggregate euro area fiscal stance for next year appears broadly appropriate in light of historically low interest rates and high external surplus existing in the euro area. At the same time, debt ratios remain at very high levels and only slowly decreasing, implying the need to vigorously resume consolidation once the recovery takes hold.
5. Because of their very nature, temporary savings from low interest payments need to be used wisely: they should be reflected in lower deficits in countries with large budgetary imbalances and allow a larger increase in public investment in countries with fiscal space. The present fiscal plans are only partly in line with such predicament.
6. Concerns regarding sustainability are confirmed by the slight deterioration projected for the euro area structural balance in the Commission's forecast for 2016, which may fall short of the average adjustments required of euro area Member States under the SGP. Moreover, this is being driven by a very small or even negative adjustment on the part of Member States that are facing sustainability concerns, notwithstanding a still insufficient orientation in other Member States towards making use of the available fiscal space.
7. The analysis of the appropriateness of the fiscal stance in the euro area is complemented by an

examination of the composition of public finances. While the recent moves to reduce the tax burden on labour go in the right direction, the composition of expenditure shows limited progress towards being more growth-friendly, with capital expenditure still expected to decline as a share of GDP.

8. The budgetary impact of the exceptional inflow of refugees is mentioned in a few DBPs. Other Member States may also be concerned in the meantime or might be in the future. The flexibility embedded in the SGP allows accommodating the incremental spending in a given year linked to unusual events outside the control of the government, both under the preventive and the corrective arm of the Pact. The Commission is willing to use these provisions. It will monitor the situation closely on the basis of observed data as provided by the authorities of the concerned Member States to determine eligible amounts. This information will be used when assessing (ex post) possible temporary deviations from the SGP requirements for 2015 and 2016. This means that deviations deriving only and directly from the net extra costs of the refugee crisis will not lead to any stepping up in the procedures. This applies also to the opening of an Excessive Deficit Procedure provided that the general government deficit remains close to 3% of GDP in case of a breach of that threshold.

9. The Commission's assessment of individual Member States' plans can be summarised as follows:

No DBP for 2016 has been found in particularly serious non-compliance with the requirements of the SGP. In several cases, however, the Commission finds that the planned fiscal adjustments fall short, or risk doing so, of what is required by the SGP.

Specifically:

Regarding the twelve countries in the preventive arm of the SGP:

- for five countries (**Germany**, **Estonia**, **Luxembourg**, **the Netherlands** and **Slovakia**), the DBPs are found to be **compliant** with the requirements for 2016 under the SGP.

- for four countries (**Belgium**, **Latvia**, **Malta** and **Finland**), the DBPs are found to be **broadly compliant** with the requirements for 2016 under the SGP. For these countries, the plans might result in some deviation from the adjustment paths towards each country's medium-term budgetary objective.

- for three countries (**Italy**, **Lithuania** and **Austria**), the DBPs pose a **risk of non-compliance** with the requirements for 2016 under the SGP. The DBPs of these Member States might result in a significant deviation from the adjustment paths towards the medium-term objective.

Regarding the five countries currently in the corrective arm of the SGP (i.e. in Excessive Deficit Procedure):

- for three countries (**France**, **Ireland** and **Slovenia**), the DBPs are found to be **broadly compliant** with the requirements for 2016 under the SGP. In the case of France, while the recommended headline deficit target is projected to be met in 2016, the DBP contains risks as regards compliance with the Excessive Deficit Procedure requirements as the fiscal effort is projected to fall significantly short of the recommended level, according to all metrics. The Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2016 budget will be compliant with the SGP. Ireland and Slovenia could move to the preventive arm of the Pact from 2016 in case a timely and sustainable correction of the excessive deficit is achieved in 2015. For 2016, there is a risk of some (but close to significant in the case of Slovenia) deviation from the adjustment path towards the medium-term objective in 2016.

- for **Spain**, the DBP presented on 11 September was found to pose a **risk of non-compliance** with the requirements for 2016 under the SGP. In particular, neither the recommended fiscal effort nor the headline deficit target for 2016 is forecast to be achieved. The Commission invited the authorities to take the necessary measures within the national budgetary process to ensure that the 2016 budget will be compliant with the SGP and invited the submission of an updated DBP as soon as possible.

- moreover, the Commission urges **Portugal** to present a DBP as soon as possible.

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1. Introduction

EU legislation foresees that euro area Member States submit Draft Budgetary Plans (DBPs) for the following year to the Commission by 15 October with the aim of improving coordination of national fiscal policies in the Economic and Monetary Union[1]. These plans summarise the draft budgets that governments submit to national parliaments. On each plan, the Commission provides an Opinion, assessing whether it is compliant with the country's obligations under the Stability and Growth Pact (SGP). The Commission is also required to provide an overall assessment of the budgetary situation and prospects for the euro area as a whole. The latter assessment is provided in the present Communication.

Sixteen euro area Member States sent their 2016 DBPs to the Commission by 15 October, in line with the provisions of the so-called Two-Pack. Greece and Cyprus, the remaining euro area countries under a macroeconomic adjustment programme, are not obliged to submit a plan, as the programmes already provide for close fiscal monitoring. Spain already submitted its DBP in September and the Commission adopted its Opinion on 12 October.

Portugal did not submit a plan as required by the legislation. This has not happened before and should not be repeated. Even a no-policy change DBP, which is considered acceptable in case of elections, provides valuable and transparent information on underlying budgetary trends, which facilitates a collective examination of the overall fiscal stance in the euro area and ensures equal treatment across Member States.

While respecting Member States' budgetary autonomy, the Commission's Opinions provide objective policy advice, in particular for national governments and parliaments, to facilitate the assessment of the draft budgets' compliance with EU fiscal rules. The Two-Pack provides for a comprehensive toolbox to treat economic and budgetary policy as a matter of common concern, as intended by the Treaty.

In addition, in July 2015, the Council invited the Eurogroup to monitor and coordinate euro area Member States' fiscal policies and the aggregate fiscal stance for the euro area to ensure a growth-friendly and differentiated fiscal policy[2]. The Council recommended that euro area Member States, without prejudice to the fulfilment of the requirements of the SGP, "coordinate fiscal policies to ensure that the aggregate euro area fiscal stance is in line with sustainability risks and cyclical conditions". This recommendation is an anchor for the Commission's assessment.

The objective of this Communication is twofold. Firstly, it provides an aggregate picture of budgetary policy at euro area level, building on a horizontal assessment of the DBPs. This exercise mirrors the horizontal assessment of Stability Programmes that takes place in the spring, but with a focus on the forthcoming year rather than on medium-term fiscal plans. Secondly, it provides an overview of the DBPs at country level, explaining the Commission's approach in assessing them, specifically, for compliance with the requirements of the SGP. The assessment is differentiated according to whether a Member States is in the preventive or the corrective arm of the SGP and it also takes into account the SGP requirements in relation to the level and dynamics of government debt.

1 As set out in Regulation (EU) No 473/2013 on common provisions for monitoring and assessing Draft Budgetary Plans and ensuring the correction of excessive deficits of the Member States in the euro area. It is one of the two Regulations in the so-called Two-Pack which entered into force in May 2013.

2 Council Recommendation of 14 July 2015 on the implementation of the broad guidelines for the economic policies of the Member States whose currency is the euro (OJ C 272, 18.8.2015, p. 100).

2. Fiscal adjustment in the euro area according to national plans

Overall findings

The recovery from the economic and financial crisis is gradually gaining momentum in the euro area. According to the macroeconomic assumptions provided in the DBPs, GDP will grow by 1.7% in 2015 in the sixteen Member States concerned (EA-16), slightly above the 1.4% expected at the time of the Stability Programmes (SPs) in April 2015 (Table 1). For 2016, the growth outlook is broadly unchanged from the spring, with GDP growth forecast at 1.9% in the EA-16 versus 1.8% projected in the SPs. With the recovery forecast to gain pace, the difference between actual and potential output is narrowing. According to the plans, the output gap in the EA-16 is projected to be -1½% of potential GDP in 2015 and to narrow further to -¾% in 2016, having been as large as -2½% in 2013. This trend is evident in the vast majority of Member States, though not without differences across countries. The inflation outlook remains subdued, broadly unchanged since spring. According to the DBPs, the rate of inflation will be 0.4% in 2015 and is projected to increase to 1.1% in 2016 (unchanged from the SPs).

The aggregate headline budget deficit is planned to continue to narrow this year and next. In the EA-16, the deficit is forecast to be 1.9% of GDP in 2015, down from 2.4% last year[3]. In 2016, the aggregate deficit ratio is planned to decline only slightly, to 1.7% of GDP. This is in contrast to the 0.4 percentage point reduction in 2016 projected in the SPs. Together with the marginally upgraded macroeconomic outlook, this suggests that the smaller reduction in the deficit may be driven by a lower fiscal effort (see hereafter). However, an increase in expenditures related to the refugee crisis is likely to be a contributory component in a few Member States.

A continuing pause in consolidation as measured by the change in the aggregate structural balance is confirmed in the DBPs over 2015-16. This is broadly in line with the projections for the entire 2015-16 period included in the spring SPs (the structural balance was at that time planned to remain unchanged both in 2015 and in 2016). The SPs had themselves mirrored the position in Member States' DBPs in autumn of last year, which indicated a halt to consolidation in 2014 continuing into 2015. According to the DBPs, the structural balance is now planned to improve in 2015 (¼% of GDP), to be followed, however, by a ¼% of GDP deterioration next year[4]. The pause in fiscal consolidation takes place against the background of a gradually improving but still fragile economic outlook and narrowing output gap. Together with the fact that only six Member States (and only one amongst the largest economies) plan to be at or above their medium-term budgetary objectives at the start of 2016[5], this points to the planned structural adjustment in 2016 falling short of the requirements of the SGP. However, the aggregate adjustment should only be viewed as illustrative in this respect, as it fails to capture the important differences across Member States vis-à-vis the requirements of the SGP, which are the subject of the Commission's country-specific assessments.

After peaking in 2014 at 92% of GDP, the aggregate debt ratio is planned to slightly decrease both in 2015 and in 2016, broadly in line with the projections underpinning the SPs. This is driven by nominal GDP growth and negative stock-flow adjustment (meaning that factors other than the

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3 When referring to Member States' plans, data for 2014 are based on the figures included in the DBPs and thus may not incorporate the revisions made by Eurostat as part of the autumn 2015 EDP notification.

4 The deterioration in the structural budgetary position in 2016 at the aggregate level is confirmed by using an alternative measurement of discretionary fiscal effort, also known as the DFE, which suggests a slightly negative adjustment according to the DBPs versus ¼% of GDP projected at the time of the SPs (Table A5.7 of Annex 5). The DFE is an alternative indicator of the fiscal stance developed for analytical purposes and is separate from the indicators used to assess compliance under the SGP. It consists of a 'bottom-up' approach on the revenue side and an essentially 'top-down' approach on the expenditure side. For further information, see part III of "Report on Public Finances in EMU 2013", *European Economy*, 4, 2013.

5 Germany, Estonia, Lithuania, Luxembourg, the Netherlands and Austria. Moreover, two Member States are expected to remain in Excessive Deficit Procedure next year, namely Spain and France.

government deficit are planned to reduce debt)[6]. At 89% of GDP in 2016, the aggregate ratio masks a wide range of national figures. The debt ratios in individual Member States vary from 131% of GDP in Italy to just below 10% of GDP in Estonia. Data for Greece, Cyprus and Portugal, three Member States with high debt levels, are not included.

Table 1: Overview of economic and budgetary aggregates (EA-16) for 2015-16

	2015			2016		
	2015 Stability Programmes (April)	**Draft Budgetary Plans (October)**	**Commission autumn 2015 forecast (November)**	**2015 Stability Programmes (April)**	**Draft Budgetary Plans (October)**	**Commission autumn 2015 forecast (November)**
Real GDP growth (% change)	1.4	1.7	1.6	1.8	1.9	1.8
HICP inflation (% change)	0.4	0.4	0.1	1.2	1.1	1.0
Headline balance (% GDP)	-2.1	-1.9	-2.0	-1.6	-1.7	-1.7
Change in structural balance (p.p. GDP)	0.0	0.2	0.0	0.0	-0.3	-0.1
Debt (% GDP)	91.4	91.1	91.6	90.1	89.8	90.5
Cyclically-adjusted expenditure ratio (% potential GDP)	47.4	47.6	47.7	47.1	47.5	47.5
Cyclically-adjusted revenue ratio (% potential GDP)	46.5	46.7	46.7	46.3	46.2	46.3

Impact of refugee crisis

In a number of cases the DBPs mention the budgetary impact of the exceptional inflow of refugees (Austria, Belgium, Germany and Italy). While the DBPs represented an obvious vehicle for submitting specific information on the possible refugee-related budgetary costs, the very nature of this unusual event[7] and the fact that DPBs are limited to euro area Member States implies other Member States may submit their information through different documents. This is also necessary as the situation continues to evolve on the ground.

6 The planned reduction of the aggregate debt ratio is much smaller when excluding Germany from the aggregate (-0.7 versus -2.5 percentage points over 2015-16 taken together).

7 Finland also provided information regarding the projected costs associated with the increased number of refugees in 2015 in a letter putting forward the other relevant factors to be considered in the context of their report under Art. 126 (3) TFEU.

The flexibility embedded in the SGP allows for accommodating exceptional spending linked to unusual events outside the control of the government, both under the preventive and the corrective arm of the Pact. The preventive arm of the Pact explicitly envisages that temporary deviations with respect to the required fiscal adjustment towards the medium-term budgetary objective (MTO) can be allowed ex ante and could, in any case, be left out of consideration ex post based on outturn data, provided that they result from i) an unusual event, ii) outside the control of the Member State, iii) with a major impact on the financial position of the general government and iv) not endangering fiscal sustainability in the medium term. The corrective arm envisages a similar provision with regard to opening an EDP, when defining as exceptional an excessive deficit that results "from an unusual event outside the control of the Member State concerned and with a major impact on the financial position of general government", provided that the deficit remains close to 3% of GDP. Unexpected costs related to the refugee inflows can also be taken into account in the assessment of 'effective action' when assessing compliance with the EDP recommendation.

It should be stressed that **the adjustment requirements under the SGP, in both the preventive and the corrective arms, are set in terms of change in the structural balance**. Therefore, the corresponding allowances under the 'unusual event' provisions should (only) reflect the extent to which such events affect the annual change in the structural balance, compared to that which would have been otherwise observed in the absence of the event itself. The Commission will thus in principle use these provisions of the SGP when assessing (ex post) the temporary deviation from the requirements for 2015 and 2016 due to the additional costs in each of these two years resulting from the exceptional inflow of refugees compared to the previous year. Where relevant, the Commission opinions on the DBPs include factual statements on how the assessment of compliance could be impacted if we were to correct for the refugee costs.

The Commission will make a final assessment on a case by case basis, including on the eligible amounts, on the basis of observed data as provided by the authorities of the concerned Member States. The budgetary costs related to refugee inflows will not be considered as one-offs, as the additional expenditure is not necessarily temporary and non-recurrent. They should also be directly linked to, and the immediate consequence of, the refugee inflows (e.g. sheltering and administrative costs, local reception, transports, etc.) and be net of any targeted contribution from relevant EU-funds (and in general from the EU budget).

Composition of fiscal adjustment

The DBPs envisage only limited changes in the composition of public finances in 2015-16 for the euro area as a whole (Table A5.5 and Graphs A5.1a-b of Annex 5). The ratio of government expenditure to GDP is planned to recede by 0.6 percentage points in 2016. However, this seemingly large reduction is mostly due to the cyclical conditions. In fact, the expenditure ratio corrected for the effect of the economic cycle depicts a reduction of just ¼ percentage points. This reduction is outweighed by planned tax cuts, as evidenced by the stronger decline in the cyclically adjusted revenue ratio (-½ percentage points in 2016). In this respect, Members States' plans to reduce expenditure as a share of potential output have, in the aggregate, to a large extent failed to materialise over the last few years. The Commission's autumn 2015 forecast (henceforth the 'Commission's forecast') confirms the small reduction in the structural expenditure ratio and the larger one in the structural revenue ratio foreseen in the DBPs. The broadly unitary tax elasticity implied by both the DBPs and the Commission's forecast indicates that the reductions in revenues are driven by government measures (Table A5.6 of Annex 5).

Examining the growth-friendly nature of the aggregate expenditure plans set out in the DBPs, the planned adjustment is not expected to damage medium-term growth prospects, though there may be scope for more growth-friendly choices in reducing spending. Most expenditure categories are planned to fall as a percentage of output. The largest declines are affecting compensation of employees, social benefits and government purchases of goods and services (Graph A5.2 of Annex 5). Moreover, Member States are benefitting from large savings on interest expenditure (as discussed in more detail in the next section). As the most productive expenditures are not primarily impacted, the planned adjustment is not expected to damage medium-term growth prospects, though there may be scope for more growth-friendly choices in reducing spending. In particular, capital expenditure is also planned to recede. The Commission's forecast is broadly in line with the DBPs, confirming the largest reductions in social benefits and public wages, but foresees a smaller fall in government purchases of goods and services. The Commission's forecast also projects a slightly larger role for falls in interest expenditure than set out in the DBPs.

Measures presented in the DBPs would only have a moderate effect on the tax composition for the aggregate EA-16 in 2015. Indeed, all three main categories (indirect taxes, direct taxes and social contributions) are expected to recede as a share of GDP, without however altering their relative weights significantly. On the revenue side, the Commission's forecasts are aligned with the DBPs (Graph A5.3 of Annex 5).

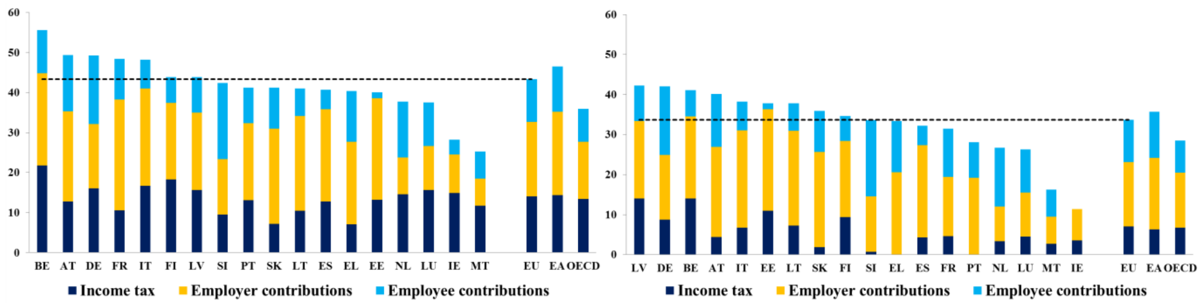
Nonetheless, **the DBPs show a clear awareness in euro area Member States of the benefits of reducing the tax burden on labour** and many Member States are planning or implementing a variety of concrete measures (Table 2). While many measures are relatively modest compared to the size of the challenge faced, some Member States' DBPs include ambitious packages of labour tax reductions that are likely to have a significant positive impact on growth and employment. The most sizable reforms are introduced in those Member States that currently have relatively high labour taxes compared to the EU average such as Austria, Belgium and France. At the same time, some Member States that have relatively low labour taxes introduce relevant measures as well. Measures are generally well targeted, focussing on those groups for which high labour taxation presents the greatest employment obstacles. In practice, this usually implies the reduction of taxes at low-income levels, with several Member States increasing the tax free allowance while some reduce rates or shift brackets to reduce the tax burden on low-income earners. Some Member States reduce taxation for middle-income earners as well while the few tax increases that are included in the DBPs pertain to higher-income earners. Most DBPs do not provide detail on the financing of labour tax reductions. In at least some cases, the full or permanent financing does not appear to be fully ensured.

Box 1: Monitoring the tax burden on labour

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. High labour taxes reduce incentives to look for work, work additional hours, to hire new staff and to pay higher wages. These effects are particularly pronounced for some groups such as low-income earners.

The Eurogroup has expressed its commitment to reduce the tax burden on labour in the euro area[8] and adopted a number of common principles for labour tax reforms related to their design, their financing, the broader policy context and the political and societal support[9]. In September 2015, it agreed to benchmark euro area Member States' tax burdens on labour against the EU average[10]. Within the euro area, there are large differences between Member States in terms of the size of the tax burden on labour and its composition (personal income taxes, employer social security contributions, employee social security contributions) as illustrated in the graphs below. The line in the graphs represents the EU average, used as a reference in this screening, whereas the non-weighted OECD average is included in the graph for broader comparability.

The tax burden on labour at the average wage and a low wage (2014)



Notes: The indicator shown in the graph is the tax wedge on labour. Data for Latvia, Lithuania and Malta is for 2013. No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.
Source: European Commission Tax and Benefit Indicator database based on OECD data.

This cross-country screening is only a first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that any labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. Furthermore, it should be kept in mind that country-specific choices with regard to the level of social protection impact the level of social security contributions, in particular pension contributions – in this regard personal income taxes and social security contributions are of a different character. An in-depth country-specific analysis, taking account of all relevant information, is carried out in the context of the European Semester.

Commission's autumn 2015 forecast and DBPs

Regarding the overall economic and fiscal outlook, the picture emerging from the sixteen DBPs is broadly confirmed by the Commission's forecast, which also points to a continued albeit moderate economic recovery amid more challenging global conditions. **The Commission's forecast projects that real GDP growth will stand at 1.6% in 2015 and strengthen further to 1.8% in 2016.**

8 http://www.consilium.europa.eu/en/meetings/eurogroup/2014/07/07/.
9 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/144872.pdf.
10 http://www.consilium.europa.eu/en/press/press-releases/2015/09/12-eurogroup-statement-structural-reform/.

Domestic demand is currently supported by a conjuncture of low oil prices, a still relatively low euro exchange rate, accommodative monetary policy and a broadly neutral fiscal stance. At the same time, the underlying dynamics of domestic demand remain slow. Global economic conditions have weakened, notably in China and some other emerging market economies, and world trade has slowed down sharply. Moreover, a number of developments could result in lower growth than expected by the Commission, such as a further deterioration of world trade, larger-than-expected spillovers from the slowdown in emerging economies, or contagion via financial markets.

The improving economic conditions are also reflected in a continuing narrowing in the difference between actual and potential output in the Commission's forecast. The negative output gap of 2¼% of potential GDP in 2014, is expected to contract to 1¾ % this year and 1% in 2016.

The pick-up in growth prospects is not reflected in price developments, as **the inflation outlook remains muted at the aggregate level**. The Commission's forecast projects HICP inflation of just 0.1% this year, with a forecast pick-up to 1% in 2016, reflecting a gradually closing output gap and a very accommodative monetary stance. Notwithstanding non-negligible differences across Member States, interest rates are assumed to stay at historically low levels in 2016. At the same time, the large excess of saving over investment is expected to persist in 2016, with the external balance of the euro area forecast in surplus by 3.6% of GDP, only marginally below its size in 2015 (3.7% of GDP). This external surplus, one of the world's largest in value terms, is only partly due to the effect of the lower euro exchange rate and low commodity prices. It also points to a lack of domestic demand and indicates that the recovery is to a large extent dependent on external factors.

The aggregate headline deficit is expected to decline from 2.0% of GDP in 2015 to 1.7% of GDP in 2016, with the structural balance remaining unchanged this year and slightly deteriorating in 2016. That said, the lack of improvement in the structural balance in 2015 anticipated by the Commission incorporates a projected decrease in interest expenditure, reflecting the fact that sovereign bond yields have fallen sharply since end-2013 and reached historically lows in the first half of 2015. As a result of lower interest rates, total interest payments by euro area Member States have decreased over the last few years as large amounts of debt have been rolled over since the fall in interest rates (Annex 4).

At the aggregate level, the structural primary balance is thus estimated to deteriorate by ½% of GDP in 2015. Similarly, the Commission expects that the slight structural worsening in 2016 will be more pronounced (-¼ of GDP) when assessed on the basis of the primary balance. The windfall gains arising from such historically low levels of interest rates on government debt provide an opportunity to Member States primarily to consolidate public finances and – depending on their specific situation – invest in infrastructure and reform their economies[11].

While **the aggregate picture for the deficit in the euro area broadly coincides between the DPBs and the Commission's forecast**, differences between individual DBPs' and the Commission's deficit forecast can be relatively large, for reasons varying from one country to another. In the majority of countries, the Commission forecasts the deficit to be higher compared to the respective DBPs, with the largest such differentials seen in Spain, Belgium and Slovakia (Table A5.1 and Graph A5.4 of Annex 5). The remaining positive forecast differentials are all within a 0.3 percentage point range, while the Commission's forecast is for a lower deficit figure in Germany, Estonia and Finland.

The Commission forecasts slightly higher aggregate debt than projected by Member States. While the aggregate debt ratio remains at a very high level, the Commission expects it to decline both this year and next, reaching 90% of GDP in 2016. However, it should also be recognised that a large portion of the debt reduction in the euro area is being driven by Germany. When Germany is excluded from the calculations, the aggregate debt ratio forecast by the Commission only stabilises in 2016 at 100% of GDP. Here again, differences between the DBPs and the Commission's forecast can be larger at Member State level, for reasons varying from one country to another. The larger differentials relate

[11] These principles were affirmed by the Eurogroup on 5 October 2015: http://www.consilium.europa.eu/en/meetings/eurogroup/2015/10/05/.

to Spain and Ireland (Table A5.3 and Graph A5.5 of Annex 5). In most cases, the forecast differentials range between zero and 1% of GDP.

The aggregate euro area debt ratio cannot be assessed in terms of compliance with the debt requirements of the SGP as the Member States of which it is comprised have a differing status vis-à-vis the SGP[12]. However, eight euro area Member States that submitted DBPs are subject to the debt reduction benchmark. According to the Commission's forecast, six of these eight are expected to be compliant with it.

Assessment of fiscal adjustment in the euro area

Regarding the size of structural budgetary adjustment, **the Commission's forecast confirms the continuation of a broadly neutral fiscal stance in 2016 in the euro area**, following the virtual halt to fiscal consolidation that has occurred since 2014. This is confirmed by an alternative measurement of the discretionary fiscal effort, which shows a slight deterioration in the fiscal position in both 2015 and 2016.

In terms of the appropriate stance at the aggregate level**, the orientation of the fiscal position in 2015-16 should be assessed against the twin objectives of long-term sustainability of public finances and short-term macroeconomic stabilisation.** Long-term sustainability requires that public debt is put and maintained on a sustainable path, taking into account the current level of debt and projected future ageing-related expenditures[13]. Macroeconomic stabilisation could be expressed in terms of closing the output gap at an appropriate pace in the short to medium term while, in the current situation, also ensuring a rotation from external to domestic sources of growth. The macroeconomic policy tools available to deliver this objective are constrained in the current monetary policy context, where nominal interest rates are already almost at the zero limit alongside very low inflation, placing further emphasis upon the importance of fiscal policy. Assessing the aggregate euro area fiscal stance against sustainability risks and cyclical conditions suggests a need to reduce further the still high debt ratio, without hampering the economic recovery and while avoiding pro-cyclical policies. In this regard, preliminary Commission calculations indicate that some moderate consolidation in 2016, as required in the country-specific recommendations and suggested by sustainability indicators, would be consistent with a reduction of the output gap. By contrast, a fiscal stance that would aim at closing the output gap at a faster pace may be at the expense of improving sustainability and prove incompatible with compliance with the requirements under the SGP.

Balancing these two objectives, **the largely neutral aggregate euro area fiscal stance expected for next year appears broadly appropriate,** when also taking into account the historically low interest rates and the high external surplus, which would indicate the need for some degree of demand support. At the same time, because of their non-permanent nature, savings from low interest payments could represent a risk if used to permanently increase government spending or cut taxes.

Concerns regarding sustainability are confirmed by the slight deterioration projected for the euro area structural balance in the Commission's forecast for 2016, which may fall short of the average adjustments required of euro area Member States under the SGP[14]. Moreover, this is being driven by a very small or even negative adjustment on the part of Member States that are facing

[12] Member States' debt requirements under the SGP differ depending on whether they are in the corrective or preventive arm and whether their debt ratio is above or below 60% of GDP.

[13] The Commission's S1 sustainability indicator, which shows the total effort required over 2016-21 so as to bring debt to 60% of GDP by 2030, taking into account contingent liabilities related to ageing, points to an adjustment of approximately ¼% of GDP in 2016 and subsequent years.

[14] The calculation of an aggregate adjustment requirement for the euro area is complicated by a number of factors, most notably the treatment of over-achievers and assumptions regarding the targeting of a headline or structural adjustment for Member States under the corrective arm. However, in light of a required minimum structural improvement of 0.5% of GDP as a benchmark under the corrective arm and a similar benchmark adjustment under the preventive arm, the slight deterioration projected by the Commission for the euro area would most certainly fall short of an aggregate requirement.

sustainability concerns, notwithstanding a still insufficient orientation in other Member States towards making use of the available fiscal space.

3. Overview of individual Draft Budgetary Plans

The Commission's Opinions on the Draft Budgetary Plans focus on compliance with the SGP and recommendations issued on this basis. For Member States in Excessive Deficit Procedure (EDP), the Commission's Opinions take stock of progress in correcting the excessive deficits, with respect to both headline and structural deficit targets. For Member States in the preventive arm of the Pact, the Commission's Opinions assess adherence to, or progress towards, the medium-term budgetary objectives (MTOs) as well as compliance with the debt rule, to see whether the plan is in line with the SGP and the fiscal country-specific recommendations (CSRs) addressed to Member States by the Council in July.

All non-programme euro area Member States, with the exception of Portugal, submitted their DBPs by 15 October. Portugal's non-submission of a no-policy change DBP is not in line with the Two-Pack and the Commission urges Portugal to submit a full DBP as soon as possible. Spain already submitted its DBP in September and the Commission adopted its Opinion on 12 October.

No DBP was found to be in "particularly serious non-compliance" as referred to in Article 7(2) of Regulation (EU) No 473/2013. Still, several of the submitted plans give rise to concerns.

Tables 2a and 2b summarise the assessments of individual countries' DBPs as per the Commission's Opinions adopted on 16 November together with the assessment of progress with reforms relating to fiscal governance. These assessments are based on Commission's autumn 2015 forecast. In order to facilitate comparison, the assessment of the plans is summarised in three broad categories, which have different meanings depending on whether a Member State is in EDP or not:

- **Compliant:** According to the Commission's forecast, there is **no need to adapt the budgetary plans** within the national budgetary procedure to ensure compliance with the SGP rules.
- **Broadly compliant:** The Commission invites the authorities **to take the necessary measures** within the national budgetary process to ensure that the 2016 budget will be compliant with the SGP based on the following reasoning:

  For Member States in EDP: while the Commission's forecast projects that the headline deficit target will be achieved, there is a noticeable shortfall in fiscal effort compared to the recommended value that puts at risk compliance with the EDP recommendation.

  For Member States under the preventive arm of the SGP: according to the Commission's forecast, the DBP may result in some deviation from the MTO or the adjustment path towards it, but the shortfall relative to the requirement would not represent a significant deviation from the required adjustment. These Member States are assessed to comply with the debt reduction benchmark where applicable.
- **Risk of non-compliance:** According to the Commission's forecast, the DBP is not expected to ensure compliance with the SGP requirements. The Commission therefore invites the authorities **to take the necessary measures** within the national budgetary process to ensure that the 2016 budget will be compliant with the SGP based on the following reasoning:

  For Member States in EDP: the Commission's forecast for 2016, if confirmed ex post, could lead to the stepping up of the EDP as neither the recommended fiscal effort nor the recommended headline deficit target is forecast to be achieved.

  For Member States under the preventive arm of the SGP: the Commission's forecast projects a significant deviation from the MTO or the required adjustment path towards the MTO in 2016 and/or non-compliance with the debt reduction benchmark where applicable.

Following the Commission Communication on "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact" of 13 January 2015, Italy and Finland have in their DBP[15] requested flexibility deviation from the recommended adjustment path towards the MTO on the basis of the structural reform and the investment clause. It should be noted that granting flexibility at this stage would take place outside the normal European Semester cycle and depart from the process envisaged in the Communication on flexibility within the SGP. In any case, in the absence of a sufficient safety margin to the 3% of GDP deficit reference value, Finland is currently assessed as not eligible for the requested temporary deviation in 2016. Regarding Italy, it appears that the eligibility criteria for the investment clause could be met on the basis of the Commission's forecast. The Commission will take this into account in the context of the assessment of the next Stability Programme. Particular attention will be paid to whether a deviation from the adjustment path is being effectively used for the purposes of increasing investments and to the plans to resume the adjustment path towards the MTO. The Commission will also assess whether progress with the structural reform agenda is in line with the Council recommendations.

Furthermore, in a number of cases (Austria, Belgium, Germany and Italy) the DBPs mention the budgetary impact of the exceptional inflow of refugees. As outlined above, the flexibility embedded in the SGP allows accommodating the incremental (from one year to the next) exceptional spending linked to unusual events outside the control of the government (such as the extra costs due to exceptional increase in refugee inflows), both under the preventive and the corrective arm of the Pact. The Commission will make a final assessment, including on the eligible amounts, on the basis of observed data as provided by the authorities of the concerned Member States, when assessing (ex post) the temporary deviation from the requirements for 2015 and 2016.

Moreover, the Commission has preliminarily assessed the degree of overall compliance with the fiscal governance reforms outlined in the 2015 CSRs. The assessment of the DBPs is summarised in five broad categories. These are:

- **No progress:** The Member State has neither announced nor adopted any measures to address the relevant CSR.
- **Limited progress:** The Member State has announced some measures to address the relevant CSR, but these measures appear insufficient and/or their adoption/implementation is at risk.
- **Some progress:** The Member State has announced or adopted measures to address the relevant CSR. These measures are promising, but not all of them have been implemented yet and implementation is not certain in all cases.
- **Substantial progress:** The Member State has adopted measures, most of which have been implemented. These measures go a long way in addressing the relevant CSR.
- **Fully addressed:** The Member State has adopted and implemented measures that address the relevant CSR appropriately.

A comprehensive assessment of progress made with the implementation of the 2015 CSRs will be made in the 2016 Country Reports and in the context of the 2016 CSRs to be adopted by the Commission in May.

[15] Finland formally requested flexibility as part of its updated Stability Programme, submitted on 28 September 2015 together with its DBP.

Table 2a: Overview of individual Commission Opinions on the Draft Budgetary Plans – Member States currently under the preventive arm of the SGP

Country	Overall compliance of Draft Budgetary Plan with Stability and Growth Pact		Progress in implementing the fiscal-structural reforms suggested in 2015 CSRs	
	Overall conclusion based on the Commission's autumn 2015 forecast	**Compliance with the preventive arm requirements in 2015-16**	**Progress with regard to CSRs related to fiscal governance**	**Main measures in DBP to address tax wedge on labour**
BE*	Broadly compliant	2015: some deviation from the adjustment path towards the MTO 2016: some deviation from the adjustment path towards the MTO	Some progress	- Increase of tax-free allowance, further increase in standard deductible amount for professional expenses. Further increase of the 'work bonus', tax credit for low income earners. - Abolition of the 30% bracket and raising of the threshold for the second highest personal income tax bracket. - Further reduction of employee social security contributions for low-income earners. Phased reduction of employer social security contributions, partly through the absorption of existing wage subsidies, partly through additional reductions for low and medium wages. - Extension of the exemption of employer social security contributions for first employees hired by SMEs.
DE	Compliant	2015: MTO overachieved; compliance with the debt benchmark 2016: MTO overachieved; compliance with the debt benchmark	Limited progress	- Increase in the minimum income tax free allowance. - Increase in child allowances. - Adjustment of income tax brackets for fiscal drag.
EE	Compliant	2015: MTO overachieved 2016: MTO overachieved	n.a.	- Increase in tax free allowance. - Introduction of an income tax refund for low-wage earners.
IT*	Risk of non-compliance	2015: some deviation from the adjustment path towards the MTO 2016: significant deviation from the adjustment path towards the MTO	Some progress	- Reduction by 40%, for an overall duration of two years, of employer social security contributions paid for new permanent employees hired in the course of 2016. This prolongs a previously enacted full exemption for three years for new personnel hired under open-ended contracts in the course of 2015.
LT	Risk of non-compliance	2015: no deviation from the adjustment path towards the MTO 2016: significant deviation from the adjustment path towards the MTO	Limited progress	- Increase in the tax free allowance. - Increase in tax free allowance for parents and disabled people.

LV	Broadly compliant	2015: no deviation from the adjustment path towards the MTO 2016: some deviation from the adjustment path towards the MTO	Some progress	- Increase in tax free allowance. - Introduction of progressivity in tax free allowance. - Introduction of solidarity tax for high-income earners.
LU	Compliant	2015: MTO overachieved 2016: MTO overachieved	Limited progress	No related measures.
MT	Broadly compliant	2015: some deviation from the adjustment path towards the MTO; compliance with the debt benchmark 2016: some deviation from the adjustment path towards the MTO; compliance with the debt benchmark	Some progress	- Increase in tax free allowance. - Reduction of income tax rate for low-income earners.
NL	Compliant	2015: no deviation from the MTO; compliance with the debt benchmark 2016: no deviation from the MTO; compliance with the debt benchmark	Some progress	- Increase in tax credit for employed persons for incomes up to EUR 50.000. - Reduction of second and third income tax rates. - Raising of threshold for highest income tax bracket. - Increase in tax credit for parents. - Phasing out of the general tax credit.
AT**	Risk of non-compliance	2015: no deviation from the adjustment path towards the MTO; compliance with the debt benchmark 2016: significant deviation from the adjustment path towards the MTO; compliance with the debt benchmark	Limited progress	- Increase in the number of tax brackets, reduction of the entry tax-rate from 36.5% to 25% up to EUR 18.000 of annual income. - Threshold for the 50% tax rate increased from EUR 60.000 to 90.000. - A temporary 55% tax rate is envisaged for annual income above EUR 1 million. - The reimbursement of half of social security contributions for very low income earners.
SK	Compliant	2015: no deviation from the adjustment path towards the MTO 2016: no deviation from the adjustment path towards the MTO	Limited progress	No related measures.
FI***	Broadly compliant	2015: some deviation from the MTO 2016: some deviation from the adjustment path towards the MTO	Limited progress	- Adjustment, in 2016, of tax brackets to reflect the rise in earnings and inflation. - The highest income tax bracket in the central government tax scale (solidarity tax) will remain in effect until 2019 and the threshold from which it applies is lowered for the years 2016 and 2017. - Increase of tax credit for work income. - Increase in the unemployment insurance contribution by 1pp.

* The report under Art. 126 (3) TFEU of 27 February 2015 concluded that the debt criterion should be considered as complied with at that time.

** In case the current estimate of the budgetary impact of the exceptional inflow of refugees would be excluded from the assessment, the projected deviation from the recommended adjustment path would no longer be significant.

*** As the notified deficit for 2014 and the planned deficit and debt for 2015 were above the Treaty reference values, the Commission issued a report under Art. 126 (3) TFEU on 16 November 2015, concluding that both the deficit and the debt criterion should be considered as complied with.

Table 2b: Overview of individual Commission opinions on the Draft Budgetary Plans – Member States currently under the corrective arm of the SGP

Country	Overall compliance of Draft Budgetary Plan with Stability and Growth Pact		Progress in implementing the fiscal-structural reforms suggested in 2015 CSRs	
	Overall conclusion based on the Commission's autumn 2015 forecast	**Compliance with the Excessive Deficit Procedure in 2015-16**	**Progress with regard to CSRs related to fiscal governance**	**Main measures in DBP to address tax wedge on labour**
IE*	Broadly compliant	2015: in EDP 2016: some deviation from the adjustment path towards the MTO; compliance with the debt benchmark	Some progress	- Increase in the tax free allowance for the universal social charge as well as a raising of the threshold for the middle bracket and a reduction of the rate in the three lowest brackets.
ES**	Risk of non-compliance	2015: headline target not met, fiscal effort falls significantly short of the recommended level, putting at risk compliance 2016: timely correction by 2016 at risk; fiscal effort falls significantly short of the recommended level, putting at risk compliance	Some progress	- Reduction of tax rates across the income spectrum and introduction of exemptions, lowering the effective tax rate of primarily low-income earners. Introduced in two phases, 1 January and 1 July 2015, respectively. - Temporary flat rate in social security contributions until March 2015. Replaced by temporary exemption from social security contributions for the first 500 euros per month for new permanent hires under certain conditions (expires third quarter 2016).
FR	Broadly compliant based on the headline deficit target	2015: headline target met, fiscal effort falls significantly short of the recommended level, putting at risk compliance 2016: headline target met, fiscal effort falls significantly short of the recommended level, putting at risk compliance	Some progress	- Reduction of employer social security contributions for wages between 1.6 and 3.5 times the minimum wage. - Reduction of personal income tax for low-income households by a tax rebate ('décote') for low-income households.
PT*	No DBP submitted yet			
SI*	Broadly compliant	2015: in EDP 2016: some deviation from the adjustment path towards the MTO; compliance with the debt benchmark	Some progress	No related measures.

* The country is currently under the corrective arm, but could move to the preventive arm from 2016 if a timely and sustainable correction is achieved.

** The Commission adopted an Opinion on Spain's DBP on 12 October. Portugal did not submit a DBP for 2016 by 15 October.