

European Fiscal Board

# Annual Report 2020

Brussels, 20 October 2020

# Main messages: Looking back at 2019

- **Economic growth slowed but still close to potential.**
- **Headline deficit increased slightly** for the first time since 2011 (**more in structural terms**). Mostly due to **slippages in current expenditure.**
- **No country under an excessive deficit procedure (EDP)** in 2019 **but many significant deviations** in the preventive arm of the SGP.
- As before, many countries **did not** use good times to **improve public finances.**
- The **general escape clause** was rightly activated in view of Covid-19-crisis, but made non-compliance in 2019 inconsequential (except Romania).

# Main messages: Evolution of the EU fiscal framework

- 2019 experience strengthens EFB proposal to simplify and **reform the EU fiscal governance framework.**
- The Covid-19 crisis underscored **three missing elements in the current EMU architecture:**
  1. A genuine and permanent **central fiscal capacity**
  2. A **reformed and leaner SGP**
  3. A **protection mechanism for growth-enhancing government investment**
- The **NGEU and SURE are commendable** policy responses at the European level but long-term challenges remain.
- The **reform** of the fiscal framework **should be discussed and preferably agreed upon prior to the deactivation of the general escape clause.**

# Macroeconomic and fiscal developments in 2019

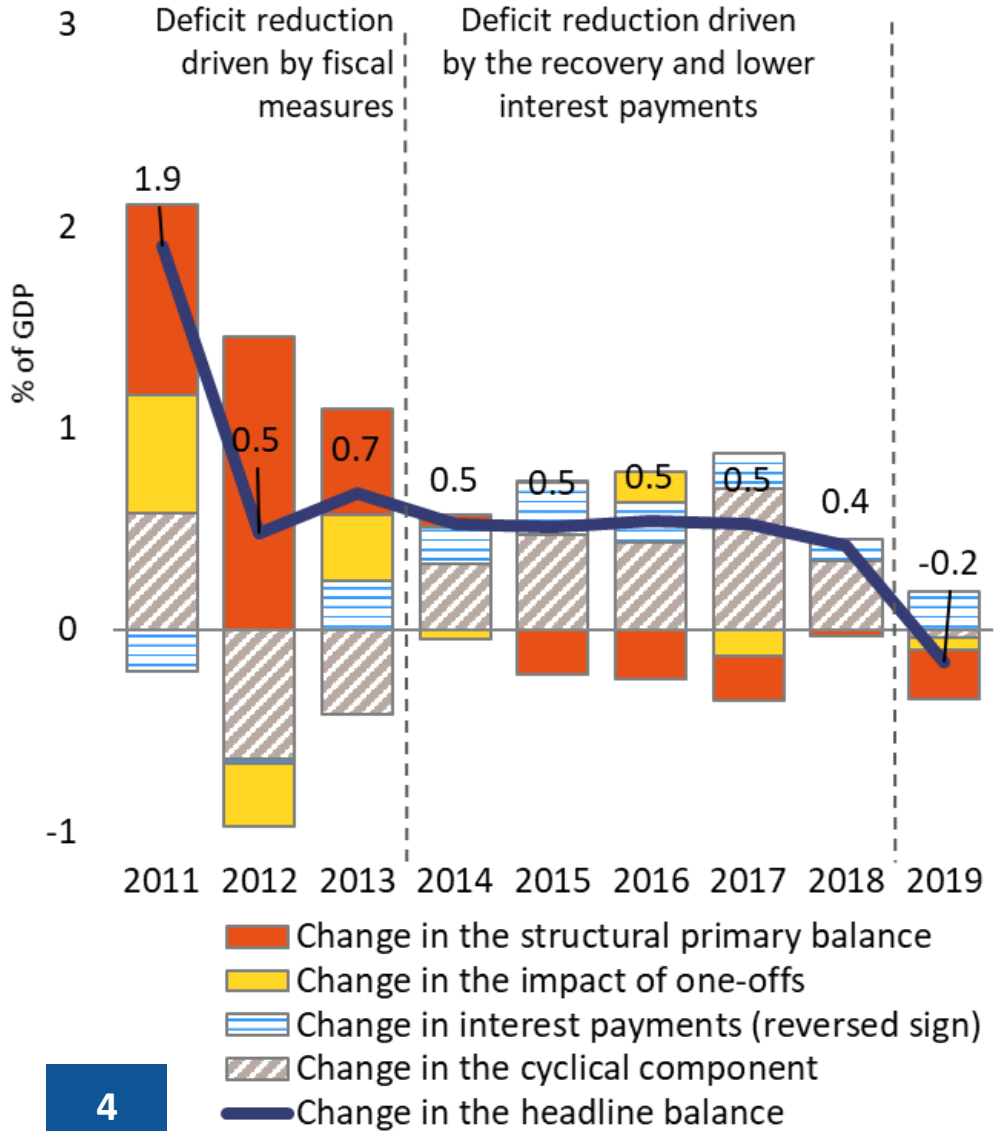
## Growth performance

- **Growth** slowed but still close to potential ( $\approx 1\frac{1}{2}\%$ ) in the EU. **Last year of long economic upswing.**
- Notable cases of **optimism in budgetary forecasts persisted.**

## Fiscal performance

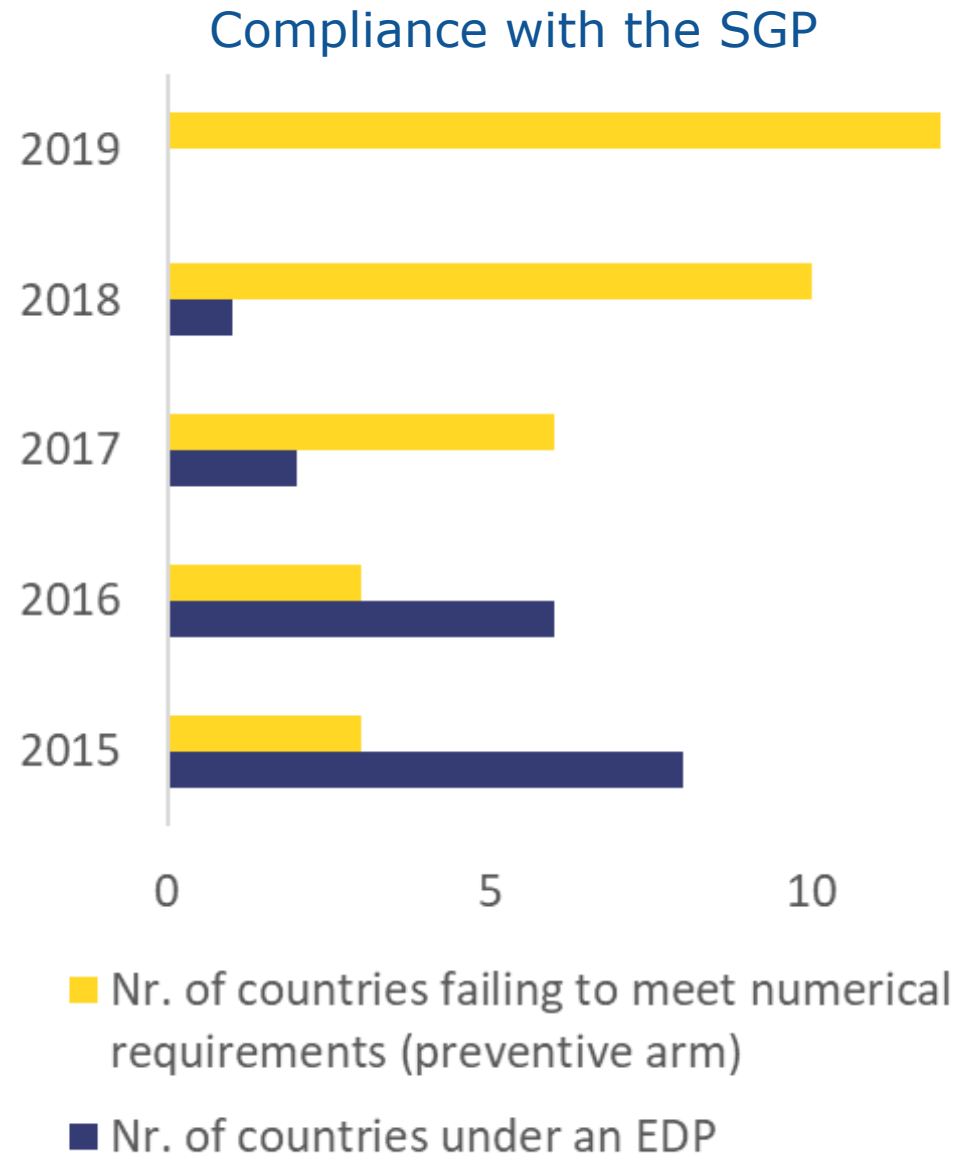
- Outturn well **below SCP target.**
- If Member States had **stuck to their original spending plans** deficit would have almost vanished in the euro area and narrowed to 0.3% of GDP in the EU.

**Budget deficit of the EU increased for the first time in eight years.**

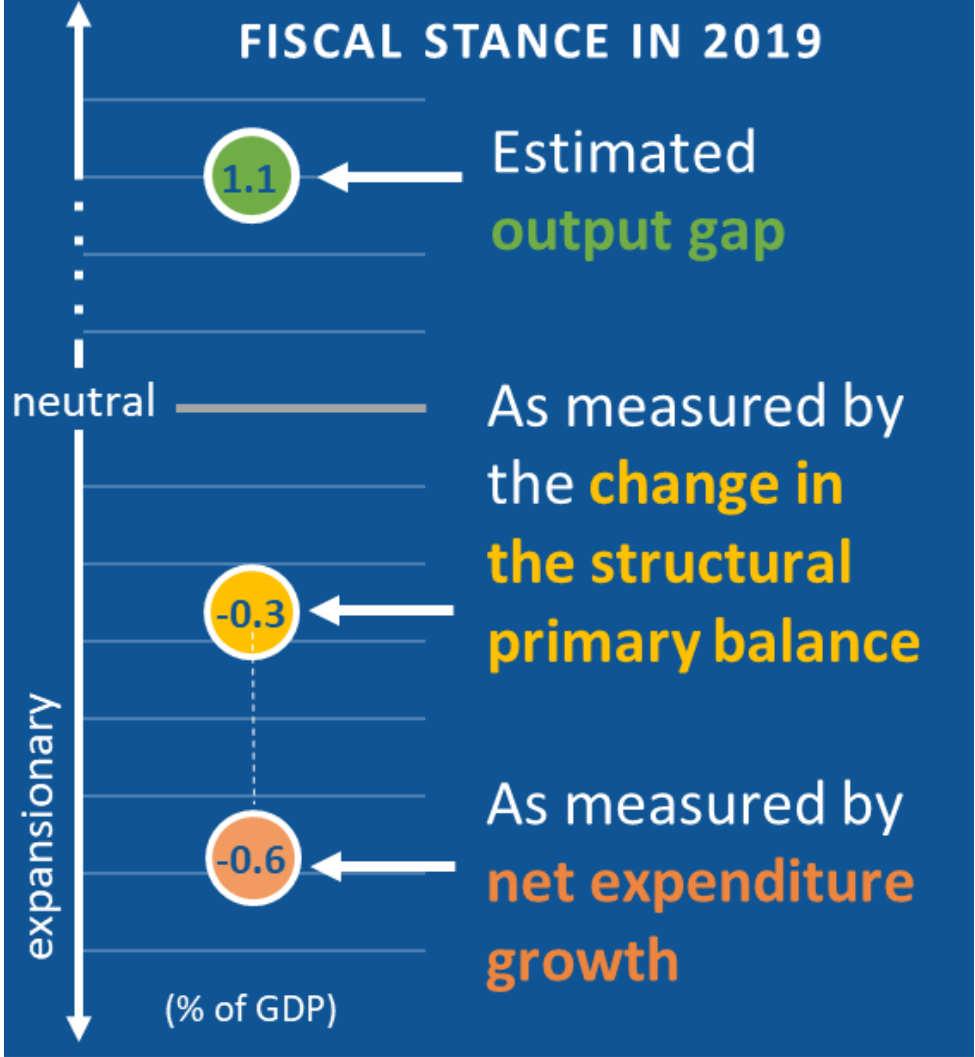


# Implementation of the fiscal rules: light and shadow

- For the first time since 2013, the Commission **rejected a draft budgetary plan** (namely Italy).
- For the first time since 2002 **no EU country under an excessive deficit procedure** (EDP).
- But **ten cases of significant deviations** under the preventive arm of the Pact (3 more than the year before).
- Commission's assessment concluded Belgium, Spain & France had **deviated from the debt reduction benchmark in 2019**.



# Fiscal stance in the euro area: unwarranted expansion



### Guidance:

- **Commission called for a broadly neutral fiscal stance** (expansion in DE & NL).
- **EFB recommended somewhat restrictive fiscal stance**, as not to waste good times.

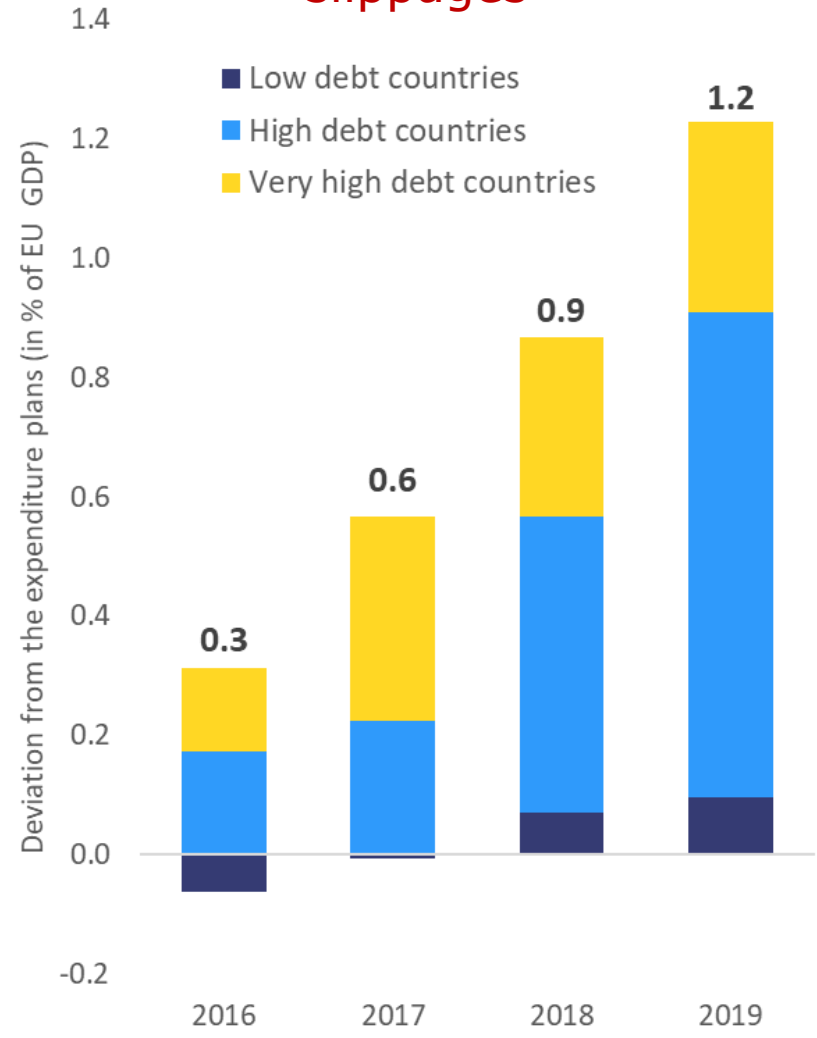
### Outturn:

- Based on **expenditure benchmark**: fiscal expansion of 0.6% of GDP.
- **Country composition not appropriate.**

# Drivers of fiscal deteriorations in 2019

- Average **numerical compliance** scores with the EU fiscal rules in the EU **worsened** in 2019 for the second year in a row.
- **Deterioration of budgetary outcomes** mainly due to expenditure slippages.
- Over the last four years, **cumulative deviations from spending plans amounted to around 3% of GDP** and only 0.1% of GDP went into additional government investment.

## Persistent government expenditure slippages



Note: Difference between actual (outturn) and projected total government expenditure in the SCP. Very high debt countries: debt ratio above 90% of GDP and high debt countries between 60% and 90% (average 2016-2019). Share in EU GDP: low-debt group (18%), high-debt group (44%), very high-debt group (38%).

# Role of Independent fiscal institutions (IFIs)

- As in previous years, **in 2019** IFIs **warned of risks of deviations** from EU rules and assessed the plausibility of macroeconomic forecasts.
- Some IFIs did not endorse the government's macroeconomic scenario (Italy) or expressed reservations (France, Portugal) as they deemed it too optimistic.
- IFI's recommendations did not lead directly to corrective measures but they **increased pressure** on governments in case of non-compliance (e.g. in 2019 are Italy and Romania).
- European Commission's **growing use of discretion** to assess budgetary plans and requirements poses a **challenge for IFIs** (assessment of IFI  $\neq$  COM).

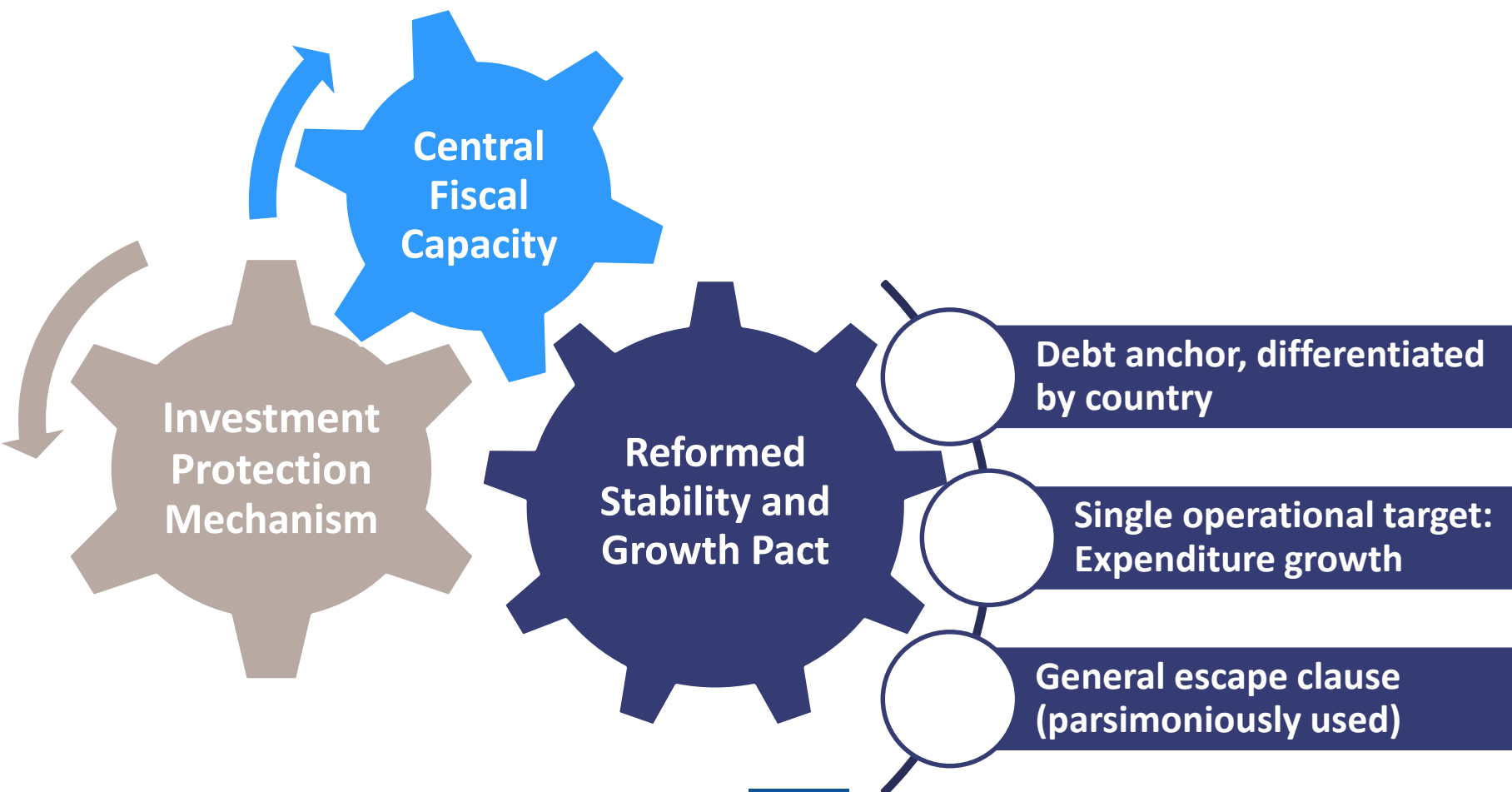


# Implementation of SGP under special circumstances

- **General escape clause** does not apply to 2019, but makes **non-compliance in 2019 largely inconsequential** (exception Romania): priority in 2020/21 is stabilisation.
- Even in the absence of formal procedures, the **unprecedented number and the size of deviations are sources of concern.**
- The current **wait-and-see approach** with EDPs stands in contrast to response in 2008-09 crisis.
- Lack of **review date for the general escape clause** should be resolved swiftly, spring 2021 at the latest. The reform of the SGP should be discussed and preferably agreed before deactivating the clause.
- The combination of a **forbearing interpretation of the EU rules in good times** coupled with **additional leeway** in the event of major shocks underscores predicaments of multilateral surveillance framework in the EU.

# Economic and Monetary Union (EMU) reform

- The Covid-19 crisis put **economic governance review** on hold.
- The Covid-19 induced economic crisis underscored **three missing elements** in the current EMU architecture:



**Thank you for your attention**

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