The concept of “Euro area fiscal stance” is increasingly used by the European Commission, the ECB, the Eurogroup, the IMF and academics, to measure the discretionary fiscal effort at euro area level. It became prominent with the publication of the Commission Communication on “Towards a Positive Fiscal Stance” of November 2016. This note provides an overview of the concept and the latest developments, as well as of positions and contributions published recently on the subject.

1. The concept of ‘Euro area fiscal stance”

The concept of “fiscal stance” is used to measure the impulse of government’s discretionary decisions on public finances, by excluding from the nominal general government budget balance the changes in expenditures and revenues that depend on the economic cycle. It is defined as the change in the general government’s primary structural balance: if the difference is negative, then the fiscal policy is expansionary; vice versa, if it is positive, the fiscal policy is contractionary. For the euro area as a whole, the fiscal stance is calculated as the sum of the national fiscal stances.

The current EMU governance framework does not contain rules or instruments that allow the direct management of the euro area fiscal stance: this represents a major difference when compared to fiscal federations. In the EMU, fiscal policies are a national responsibility: according to the Treaty, they are simply to be considered as a matter of common concern and coordinated.

So far, coordination has focused on fiscal discipline, in the hope that automatic stabilisers would cushion economic shocks during recessions. However, in addition to the monetary policy, discretionary impulse induced by fiscal policy might help to recover from financial and economic crises. For the euro area, such impulse could be measured in terms of the appropriate euro area fiscal stance. Nevertheless, economists have different views on the role of this concept in EMU policy making (Section 5 of this note presents some recent papers on this issue).

Figure 1: The Euro area fiscal stance, 2011-2018

Source: Commission forecast Autumn 2016 (Ameco database)

Figure 1 shows the evolution of the aggregated fiscal stance in the euro area during last years: it can be seen that the fiscal policy had been contractionary until 2013. According to the latest Commission forecast, the euro area fiscal policy is expected to turn slightly expansionary in 2016 and remain broadly neutral over the rest of the forecast horizon. The Annex to this note presents the fiscal stances for euro area Member States from 2011 to 2018.
2. The Commission Communication “Toward a positive fiscal stance for the euro area”

At the start of the European Semester 2017, on 16 November 2016, the Commission\(^1\) published a communication “Towards a positive fiscal stance for the euro area”, where it put itself in the position of a “Finance Minister for the euro area as a whole” that looks at the fiscal policy in aggregate terms.

The Commission considers that both the aggregate fiscal stance forecast for 2017-2018, as well as the aggregate fiscal stance obtained by summing the individual fiscal stances planned by euro area MSs in their draft budgetary plans\(^2\), are inadequate. They would lead to a moderately neutral fiscal stance in 2017 and 2018, while the economic situation would call for an expansionary policy, also in support of the monetary policy of the European Central Bank.

The Commission therefore “sets out the case for a significantly more positive fiscal stance at this point in time. A positive fiscal stance refers both to the supportive, i.e. expansionary, direction that fiscal policy should take overall, and to the quality of the composition of the adjustment, in terms of repartition of efforts across countries and of the types of expenditure and/or taxes behind it.”

More specifically, the Commission proposes a fiscal expansion of 0.5% of GDP at the level of euro area for 2017, which corresponds to an additional fiscal stimulus of around 50 billion euro. This amount is set against the objective of reducing the euro area output gap\(^3\); 0.3% would halve the output gap, whereas 0.8% would allow for a full closure of the output gap in 2017. Furthermore, a fiscal expansion of 0.5% would contribute to close, in 2017, 25% of the gap between the forecast core inflation in the euro area and the objective of 2%.

The Commission underlines that such a fiscal stance will not be the spontaneous result of the application of the rules to each Member State: actually, the current fiscal situation conceals a “clearly sub-optimal repartition of the fiscal adjustment across countries”. The Commission notes, “The current fiscal aggregate conceals a very uneven fiscal distribution across Member States, which does not make good economic sense from the point of view of the euro area. This situation has been summarised in the form of a telling paradox: those who do not have fiscal space want to use it; those who have fiscal space do not want to use it.”

For each euro area Member State, the Commission provides an analysis of the macro-economic stabilisation needs (measured by the country’s output gap) and the fiscal sustainability needs (i.e. its margin of manoeuvre under the SGP, while taking into account the flexibility clauses). Nevertheless, the Commission does not quantify the individual contribution that each Member State should provide to the overall objective: based a fiscal map, it simply identifies the Member States which have fiscal space and whose economies would benefit from limited stimulus. Furthermore, it points that “the

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\(^1\) The Commission had already signalled this perspective in their Work programme 2017. “In its next recommendation on the economic policy of the euro-area, the Commission will also promote a positive fiscal stance for the euro-area, in support of the monetary policy of the European Central Bank.”

\(^2\) See the Commission webpage on Draft Budgetary Plans 2017.

\(^3\) See EGOV note on “Potential output estimates and their role in EU fiscal policy surveillance”.

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tension between the need to support the recovery over the short term and to ensure sustainable public finances over the medium term is particularly strong in Member States with very high levels of government debt”. In this respect, the Communication on the Draft Budgetary Plans 2017: overall assessment, the Commission notes “However, designing such an appropriate fiscal stance for the euro area is the individual and collective responsibility of the Member States”.

This Commission Communication, together with its Annexes, details the analytical basis for the second recommendation on the economic policy of the euro area (see Box below) of November 2016.

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**Commission’s recommendation on the economic policy of the euro area for 2017**

At the beginning of the European semester, the Commission publishes its “recommendation on the economic policy of the euro area”. Such a recommendation will be discussed in the Eurogroup and adopted in the /Council (modifications are possible).

The Commission proposes that

” (...) euro area Member States take action, individually and collectively, within the Eurogroup in the period 2017-2018 to...

Deliver an overall positive fiscal stance contributing to a balanced policy mix, to support reforms and to strengthen the recovery through a fiscal expansion of up to 0.5% of GDP in 2017. Combine national efforts to secure long-term fiscal sustainability in respect of the Stability and Growth Pact with short-term macroeconomic stabilisation for the euro area, using all the room for manoeuvre available under the Stability and Growth Pact. Differentiate the fiscal effort by individual Member States by better taking into account:

- their respective position with regard to the requirements under the Stability and Growth Pact,
- the situation of the euro area aggregate and spillovers across euro area countries:
  - (i) for Member States which are over-achieving their fiscal objectives, use their fiscal space to support domestic demand and quality investments, including cross-border ones, as part of the Investment Plan for Europe;
  - (ii) for Member States that need further fiscal adjustments under the preventive arm of the Pact, make sure to be broadly compliant with the requirements of the Stability and Growth Pact;
  - (iii) for Member States under the corrective arm, ensure a timely correction of their excessive deficits, including by providing fiscal buffers against unforeseen circumstances.

Improve the composition of public finances by creating more room for tangible and intangible investment and ensure the effective functioning of national fiscal frameworks. (...)”

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3. Reactions to the Commission proposal on a positive fiscal stance for the euro area

At its meeting of **5 December 2016**, the **Eurogroup** “took note of the Commission Communication and analysis of the fiscal stance calling for a positive fiscal stance in the euro area. It recalled that in July, Ministers concluded, on the basis of Commission analysis, that the broadly neutral aggregate fiscal stance in 2017 strikes an appropriate balance. The Eurogroup highlighted that there a considerable differences across member states in terms of fiscal space and budgetary consolidation needs. Ministers furthermore stressed the importance of a growth-friendly composition of budgetary measures.” In addition, the **President of the Eurogroup** Mr. Dijsselbloem stated “We agreed that some member states can, if they choose to do so, use their favourable budgetary situation to strengthen their domestic demand and growth potential”.

At the Monetary dialogue with the ECON Committee of the EP of **28 November 2016**, the **President of the ECB** M. Draghi said “We take note of the Commission communication entitled ‘Towards a positive fiscal stance for the euro area’. We have said ... that in order to reap the full benefits of our monetary policy measures, other policy areas must contribute much more decisively, both at national and European level.
Fiscal policies should support the European recovery, but they also have to remain in compliance with the fiscal rules of the European Union. We agree with the Commission’s emphasis on the composition of fiscal policies; several times we have said that countries should strive for a more growth-friendly composition of fiscal policies.

The concept – and that is part of the Commission’s proposal – of the euro area fiscal stance, if correctly interpreted, can be a useful input into our policy discussion. However, it is not a legally binding constraint on Member States, which continue to be bound by the Stability and Growth Pact. Member States’ draft budgetary plans for 2017 imply a broadly neutral euro area fiscal stance, which appeared to strike a balance between aggregate stabilisation and sustainability needs. As stressed by the Commission, the contribution of individual Member States to the area-wide stance as outlined in the draft budgetary plans is sub-optimal. So Member States whose plans are at risk of non-compliance need to take additional measures to ensure compliance with fiscal rules, while other Member States have scope to use available fiscal space.”

In preparation of the Eurogroup and ECOFIN meetings at the end of January 2017, the Economic and Financial Committee and the Euro Working Group agreed to deeply modify the recommendation proposed by the Commission, as follows: “Euro area Member States take action, individually and collectively, within the Eurogroup in the period 2017-2018 to ... Aim for an appropriate balance in fiscal policies between the need to ensure sustainability and the need to support investment to strengthen the recovery, thereby contributing to an appropriate aggregate fiscal stance and a more balanced policy mix. Member States that, according to the Commission assessment, are at risk of not meeting their obligations under the SGP in 2017 should, on that basis, take, in a timely manner, additional measures to ensure compliance. Conversely, Member States that have outperformed their medium-term objectives are invited to continue to prioritise investments to boost potential growth while preserving the long-term sustainability of public finances. Member States that are projected to be broadly compliant with the SGP in 2017 should ensure compliance with the SGP within their national budgetary processes. Pursue fiscal policies in full respect of the SGP, while making the best use of the flexibility embedded within the existing rules. Overall, Member States should improve the composition of public finances, by creating more room for tangible and intangible investment and ensure the effective functioning of national fiscal frameworks.”

4. Previous institutional positions on the role of the Euro area fiscal stance

- The President of the ECB M. Draghi said in a speech (in August 2014) “It may be useful to have a discussion on the overall fiscal stance of the euro area. Unlike in other major advanced economies, our fiscal stance is not based on a single budget voted for by a single parliament, but on the aggregation of eighteen national budgets and the EU budget. Stronger coordination among the different national fiscal stances should in principle allow us to achieve a more growth-friendly overall fiscal stance for the euro area.”

- The Five Presidents’ Report of June 2015 on completing the EMU highlighted the need to ensure that “the sum of national budget balances lead to an appropriate fiscal stance at the level of the euro area as a whole. This is key to avoiding pro-cyclical fiscal policies at all times (p. 14)”. To this end, the Advisory European Fiscal Board "should advise the Commission and provide an economic judgement on the appropriate fiscal stance at Eurozone and national level, on the basis of the rules of the Stability and Growth Pact (page 23)".

- The Advisory European Fiscal Board (AEFB) that the Commission set up in October 2015 and is becoming operational in autumn 2016, will “... provide to the Commission an evaluation of the implementation of the Union fiscal framework...and the appropriateness of the actual fiscal stance at euro area and national level. ... The Board shall advise the Commission on the prospective fiscal stance appropriate for the euro area as a whole based on an economic judgment. It may advise the

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4 See EGOV note on “The advisory European Fiscal Board”.

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Commission on the appropriate national fiscal stances that are consistent with its advice on the aggregate fiscal stance of the euro area within the rules of the SGP.

- The **EP report on 2016 AGS** (adopted on 25 February 2016) welcomed the “increased attention to the euro area’s **aggregate fiscal stance**, which does not divert attention away from individual Member States’ responsibilities; recalls that a fiscal deficit in one Member State cannot be offset by a fiscal surplus in another as far as the Excessive Deficit Procedure is concerned; calls for regular monitoring of whether the aggregate fiscal stance is appropriate in view of the existing investment gap.”

- The ECB devoted an entire article of its **Economic Bulletin of June 2016** to the Euro area fiscal stance. It noted that “as at the national level, the **appropriate aggregate fiscal stance** would seek a balance between the (fiscal) sustainability and the (macroeconomic) stabilisation objectives”. However, “there may be circumstances in which the independent conduct of national fiscal policies does not result in appropriate aggregate euro area fiscal stance, and considers that there are no rules in the SGP for countries that have over-achieved their targets.” From the methodological standpoint, the assessment of the appropriateness of the euro area fiscal stance is not straightforward, notably because of the measurement of the output gap. Furthermore, “a mechanical aggregation may not adequately capture the impact of national policies on the euro area economy”: spillovers effects (mainly by trade links) should be taken into account when setting the appropriate euro area fiscal stance. It concludes, “… in the longer term, a euro area treasury could be created and equipped with fiscal instruments to contribute to the setting of the aggregate euro area fiscal stance, as it would be the only way to steer the euro area aggregate stance.”

- In its own review of euro area countries’ **2016 Draft Budgetary Plans** in November 2015, the **Eurogroup** shared the Commission opinion that the aggregate stance implied by the plans could be viewed as broadly appropriate. However, it noted that its composition across euro area countries was problematic, because countries with remaining fiscal imbalances were falling short of SGP commitments, while countries with fiscal room for manoeuvre were not making full use of it.

- In November 2015, the **Commission recommended**5 euro area Member States to take action, individually and collectively, within the Eurogroup, to “Maintain the planned broadly neutral fiscal stance in 2016. With a view to 2017, reduce public debt to restore fiscal buffers while avoiding pro-cyclicality, in full respect of the Stability and Growth Pact. Differentiate the fiscal effort by individual Member States taking into account their respective position vis-à-vis the requirements under the SGP and their stabilisation needs, as well as spillovers across euro area countries. To this end, discuss the euro area fiscal stance in time for the preparation and presentation of the Stability Programmes and the Draft Budgetary Plans.”

- In its analytical document “The 2016 Stability and Convergence Programmes - An Overview and Implication for the Euro area fiscal stance” of September 2016, the **Commission** stated that “Fiscal policy remained slightly restrictive in 2014, was neutral in 2015, and is turning modestly expansionary this year. In terms of country contributions, Germany recently moved to an expansionary stance and contributes the major part of the euro area fiscal relaxing in 2016, with Italy also easing this year, along with continued loosening in Spain over the past three years. France has in the recent past pursued moderate consolidation that tends to dwindle in 2016.” In addition, the Commission notes that “For the euro area as whole, the analysis points to a remaining trade-off at the current juncture between sustainability and stabilisation needs.”

- In June 2016 the **International Monetary Fund** (IMF), in the context of the **annual consultations with the Euro Area countries**, noted that for 2016, the euro area fiscal stance is projected to turn mildly expansionary, mainly due to higher refugee-related spending in some countries and some relaxation of the fiscal stance elsewhere. The euro area fiscal stance is expected to be slightly expansionary in 2016, before turning broadly neutral in 2017. This was deemed appropriate, given

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5 See EGOV note on **“Euro area recommendations under the 2016 European Semester”**
the combined need to reduce high debt levels and to support the closure of the output gap. According to the IMF, the fiscal effort should be differentiated by individual Member States, in compliance with the requirements under the SGP, while considering stabilization needs, as well as taking into account possible spillovers across the Member States, including for the euro area as a whole.

5. Academic papers commissioned by the EP on “Euro-area fiscal stance”

In spring 2016, the EP proposed three academic experts to provide their contribution on the subject “The Euro-area fiscal stance: definition, implementation and democratic legitimacy”. This section provides a summary of the papers.

A. Bénassy-Quéré: in her paper, the author notes that the concept of fiscal stance aims at assessing the “voluntary” impulse induced by fiscal policy, as opposed to “automatic stabilisers”. In the current economic governance framework, where only coordination among euro area Member States is possible, the design and implementation of a Euro area fiscal stance is especially difficult, in the absence of a Euro-area budget. Therefore, the only possibility is to coordinate national fiscal policies, in order to mimic what a federal budget could achieve. She argues that such “top-down” approach should apply only in “exceptional” times, when fiscal spillovers are high and the Euro area is at risk. In “normal” times, the usual “bottom-up” approach remains appropriate. The author highlights the weakness of the concept of “fiscal stance”, due to changes in the forecasts of both the actual and potential GDP growth: to overcome this problem, she proposes to rely on the current account estimates, which seem more reliable and less volatile.

In order to “distribute” the fiscal stance among euro area countries, both the output gap and current account of each country need to be taken into account, on the top of each country’s “fiscal space” that results from the debt ratio. She also proposes a calendar that could better fit the European semester and the preparation of Member States’ budgetary plans.

As far as democratic legitimacy is concerned, the legitimacy of a “top-down” approach for fiscal policy would mainly rely on “output legitimacy” (i.e., it would be based on its efficacy). However, the recently established European Fiscal Board could have an impact, by raising the level of awareness within the European and national Parliaments; the President of the EFB would appear in front of the EP and selected Member States.

Since national governments and parliaments will remain responsible for national fiscal policies, fiscal coordination will remain fragile, especially when the macroeconomic situation differs largely across Member States. Therefore, the coordination of national fiscal policies should be complemented by the development of a “fiscal capacity” for the euro area.

Kiel Institute: according to the authors of this paper, the joint euro area fiscal stance is not a useful concept, because i) only national authorities can conduct fiscal policies and ii) the concept abstracts too much from the relevant information at country level (especially debt sustainability concerns). Furthermore, from the methodological standpoint, the structural balance is a weak indicator, because it depends on the output gap and on the potential output of an economy, which have proven very volatile. The authors note that in the current context, the EU Commission requires Member States with fiscal space (i.e. sound debt position, e.g. Germany) to provide fiscal stimulus, in the hope that loosening the joint fiscal stance would help countries that cannot afford a more expansionary fiscal stance. The authors argue that this would damage the national economy and its sustainability, and would induce further business cycle divergence among euro area Member States. Furthermore, the impact on the other MSs might be opposite to the expected one, because of the monetary policy, which might consequently get tighter and of the limited trade spillovers. As a result, imposing an “aggregate fiscal stance” could be politically contested, and seen as not legitimate.

The authors propose the creation of a joint budget to support stabilisation policies, financed with member States’ contributions, focused only on addressing genuine cyclical risks. Nevertheless, such a solution might favour moral hazard, while reducing both the willingness to implement structural reforms and the high levels of public debt. Furthermore, a euro area fiscal framework should be
transparent and responsive to euro area political preferences: the current framework seems not adequate and would require an institutional reform of the EMU.

F. Giavazzi: The author of this paper argues that the concept of euro area fiscal stance has recently come to the forefront of the policy debate because the ECB reached the zero lower bound on interest rates, thereby curtailing its ability to use monetary policy to affect aggregate demand. The euro area fiscal stance could be therefore the relevant tool to offset cyclical fluctuations in output. The author’s analysis suggests that about one half of the savings that the euro area currently exports to the rest of the world (measured, at the end of 2015, by a current account surplus equivalent to 4% of the euro area GDP) could be spent (for consumption and/or investment) inside the euro area, in an attempt to move output and employment close to potential. However, difficulties arise from the fact that the euro area lacks instruments to control the euro area fiscal stance directly: in fact, the stance of fiscal policy can currently only be managed through individual actions at the level of individual Member States – and such actions run into the difficulties of fiscal policy coordination. As a possible solution, the author proposes a procedure whereby the Commission first decides the desired change in the euro area fiscal stance, and then the allocation of such a change among individual Member States, based upon their relative output gaps. Another proposal, which would require changes in the Treaty, envisages the creation of a fiscal capacity at the euro area level, through the transformation of the European Stability Mechanism in a new institution designed to play a central role in managing euro area domestic demand. The paper concludes by discussing some characteristics of the new institution, namely its governance, its resources (which would come from the issuance of “Stability Bonds”), the moral hazard concerns it may raise and its relationship with the European Commission and the European Fiscal Board,
ANNEXES

Table: Fiscal stance in Euro area and euro area Member States, 2011-2018

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Source: Commission forecast - Autumn 2016 (Ameco database)
Graph 2: Fiscal stances in Euro area and euro area Member States, 2011-2016

Source: Commission forecast - Autumn 2016 (Ameco database)

Note: positive values indicate contractionary policies, whereas negative values indicate expansionary policies.