

The Euro area fiscal stance

The concept of “Euro area fiscal stance” is used by the European Commission, the ECB, and 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. Since then, it is often mentioned in the Recommendations for the economic policies of the euro area and is the subject of a report by the European Fiscal Board. This note (which is regularly updated) provides an overview of the concept and of the latest developments.



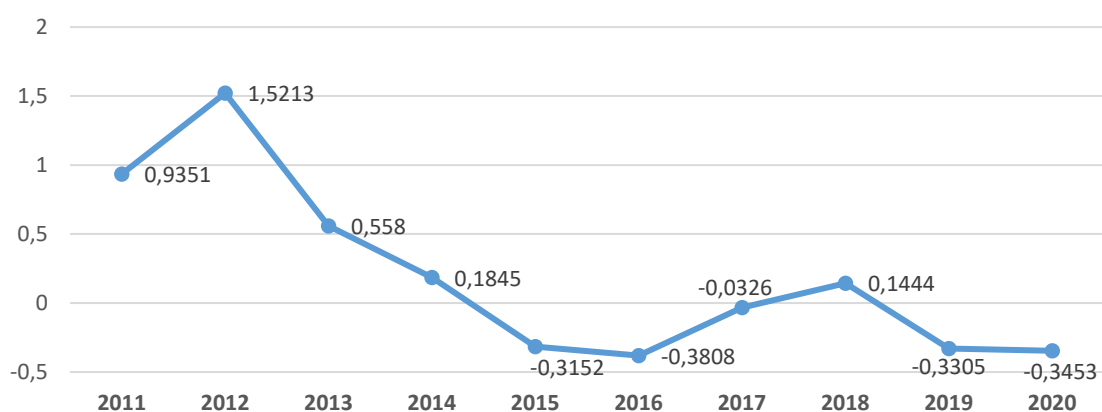
1. Overview

In public finance, the concept of “fiscal stance” is used to measure the government’s discretionary budgetary decisions with respect to the stabilisation of the economy. In addition to the monetary policy, discretionary impulse induced by fiscal policy might help to recover from financial and economic crises, or avoid overheating situations.

The fiscal stance is defined in terms of primary structural balance, which excludes both the changes in expenditures and revenues that depend on the economic cycle and the payment of interests on the sovereign debt. If the primary structural deficit in one year is greater than in the previous year, then the fiscal stance is negative and the government is applying an expansionary policy. Vice versa, if the difference is positive, then the government is applying a restrictive (or contractionary) fiscal policy.

In the current governance framework of the Economic and Monetary Union (EMU), fiscal policies are a national responsibility: according to the Treaty, they are to be considered as a matter of common concern and coordinated. Coordination mainly focuses on fiscal discipline, and stabilisation has remained a national responsibility, within the limits set in the Treaty, in the hope that automatic stabilisers would cushion economic shocks during recessions.

Figure 1: The Euro area fiscal stance, 2011-2020



Source: European Commission 2019 ([Ameco database](#)). 2019 and 2020: forecasts.



For the euro area as a whole, the stabilisation impulse is measured in terms of the euro area fiscal stance, which is calculated as the sum of the national fiscal stances of the euro area Member States. Figure 1 shows the evolution of the aggregated fiscal stance in the euro area since 2011: following several years of contractionary fiscal policies, the fiscal stance for the euro area became expansionary in 2015; it then stabilized (“broadly neutral”) until 2018, while forecasts for 2019 and 2020 predict it to be slightly expansionary. Section 2 of this note provide some detail on the fiscal stance for 2019 and 2020. The Annex presents the fiscal stances of the euro area as a whole and of individual Member States since 2011.

The term “euro area fiscal stance” was introduced by the Commission in its proposal for the [economic policy of the euro area](#) of 2012 (later adopted by the Council), which recommended to “Strengthen the working methods of the Eurogroup to allow it to take responsibility for the aggregate policy stance in the euro area, effectively responding to changes in the economic environment, and to lead the coordination of economic policy in the context of the strengthened surveillance framework which applies to the euro area Member States.” Opinions and forecast on the euro area fiscal stance are integral part of the European Semester and in line with the [Regulation on draft budgetary plans](#), which explicitly tasks the Commission and the Eurogroup to assess and discuss the budgetary situation and prospects in the euro area as a whole (See Box 1). From 2012 to 2018, the Commission has referred to the euro area fiscal stance in its Opinions on [Draft Budgetary Plans](#) and has expressed its position on the appropriate fiscal stance in its proposals for the Council recommendation on the [economic policies of the euro area](#). The [European Fiscal Board](#) (EFB), established in 2015, was tasked to assess the fiscal stance appropriate for the euro area. Nevertheless, there are no rules or instruments that allow the direct management of the euro area fiscal stance.

Section 3 of this briefing focuses on the emblematic case of November 2016, when the Commission proposed specific fiscal policies in terms of the Euro area fiscal stance, but the Council refused the proposal. In that occasion, the Commission also introduced the notion of a “Minister of Finance of the Euro area”.

Economists and politicians have different views on the role of this concept in EMU policymaking (see Box 2 below). The concluding section 4 presents the summaries of three papers on the “Euro area fiscal stance” written by external experts for the ECON Committee of the European Parliament (EP), as well as other further readings on this subject.

Box 1: The Euro area fiscal stance in EU legislation

The [Regulation on draft budgetary plans](#), adopted in 2013 as part of the 2-pack, reads: “The Commission shall make an **overall assessment of the budgetary situation and prospects in the euro area as a whole**, on the basis of the national budgetary prospects and their interaction across the area, relying on the most recent economic forecasts of the Commission services. The overall assessment shall include sensitivity analyses that provide an indication of the risks to public finance sustainability in the event of adverse economic, financial or budgetary developments. **It shall also, as appropriate, outline measures to reinforce the coordination of budgetary and macroeconomic policy at the euro area level.** The overall assessment shall be made public and shall be taken into account in the annual general guidance to Member States issued by the Commission....”

The Eurogroup shall discuss opinions of the Commission on the draft budgetary plans and the budgetary situation and prospects in the euro area as a whole on the basis of the overall assessment made by the Commission. The results of those discussions of the Eurogroup shall be made public where appropriate.”

Box 2: The concept of Euro area fiscal stance over time

This section presents some institutional opinions on the concept of 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 (page 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](#) (EFB)¹ that the Commission set up in October 2015 and became operational in autumn 2016, *“shall... 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 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 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 concluded, *“... 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 [paper](#) on “The 2019 Stability and Convergence Programmes - An overview and assessment of the euro area fiscal stance”, the Commission seems to abandon the concept of euro area fiscal stance when it notes *“It may be argued that at the current juncture the actual impact on economic growth of expansionary policies in the euro area depends more on the geographical composition than on the aggregate size of the fiscal impulse”*.

2. The Euro area fiscal stance for 2019 and 2020

In its [report](#) on “The prospective fiscal stance appropriate for the euro area in 2019” (published in June 2018), the EFB had expressed its preference for a **restrictive fiscal stance in 2019**, motivated by the need to rebuild fiscal buffers when the economy seemed to run at its full speed, with an output gap¹ expected to be 0.9% of potential GDP.

¹ See also EGOV note on [“Potential output estimates and their role in EU fiscal policy surveillance”](#).

The euro area fiscal stance for 2019 was analysed by the Commission in its [Communication on the 2019 Draft Budgetary Plans: Overall Assessment](#) of November 2018, which reads “Due to the lack of fiscal adjustment in some highly-indebted Member States, fiscal policies are insufficiently differentiated, resulting in a **slightly expansionary and pro-cyclical fiscal stance**² for the euro area as a whole. Compliance with the Stability and Growth Pact, along with the partial use of the fiscal space in some Member States, would result in a broadly neutral to mildly restrictive fiscal stance for the euro area as a whole in 2019. Such a fiscal stance would contribute to a broadly balanced overall policy mix, given the continued support to the economy from monetary policy, and would reduce the risks of financial instability”.

The latest European Commission [forecast](#) for the 2019 euro area fiscal stance shows that it is expected to be slightly expansionary (-0.3305 % of euro area GDP), as it is the one for 2020 (-0.3453).

In 2019, and for the first time since 2012, the Commission did not mention explicitly the euro area fiscal stance in its proposal for the [euro area recommendation](#) for 2020. It stated (in the introductory text) “The euro area fiscal stance remained on average broadly neutral over 2015-2018 and - based on the Commission forecast - it is projected to become **slightly expansionary in 2019**, in spite of output being above potential. Rebuilding fiscal buffers is especially important in Member States with still high levels of public debt. Doing so would also reduce their vulnerability to shocks and allow for the full functioning of automatic stabilisers in the next downturn. Increasing public investment, in particular in Member States with fiscal space, would support growth and rebalancing.” The Council kept the same text in its [Recommendation](#) adopted in April 2019.

In June 2019, the EFB published its annual “[Assessment of the fiscal stance appropriate for the euro area in 2020](#)”. Based on announced policies, it expects the euro area fiscal stance for 2020 to be on the expansionary side. Nevertheless, the EFB recommends a neutral fiscal stance, with appropriate country differentiation. The EFB notes that the recommendation for a restrictive fiscal stance for 2019 was based on the assumption that the strong growth observed in 2018 would continue; such assumption did not materialize and the economy has weakened, in particular in some countries. Therefore, the EFB calls on countries that have not yet achieved their medium-term budgetary objective (MTO) to progress towards it, as required by the Stability and Growth Pact, in particular those with very high debt, which should to reduce their debt steadily. By contrast, the EFB called on Member States with large available fiscal space (in surplus or having reached their MTO) to use more of it.

In July 2019, the [Eurogroup](#) chair concluded “There is broad consensus that for member states with high debt levels, there is a need to rebuild fiscal buffers. At the same time, countries who have already built such buffers, can prioritise investments, boost potential growth and tackle long term challenges. For 2020, based on current forecasts, appropriate and differentiated fiscal policies at the national level will lead to a broadly neutral fiscal stance for the euro area as a whole. Going forward, we will keep a close eye on the economy, given the significant number of risks to growth that are looming.”

The Commission report on “[The 2019 Stability and Convergence Programmes](#)” of July 2019 provides an overview and assessment of the Euro area fiscal stance, based on the Stability and Convergence Programmes (SCPs) that the Member States submitted in spring 2019. As for recommendation for the 2020 euro area fiscal stance, the Commission notes “Fiscal policy should ensure public finance sustainability while supporting macroeconomic stabilisation in the short term, in particular when monetary policy is constrained at the zero lower bound.” The Commission assesses these objectives through two indicators: the S1 indicator³ - to measure medium-term sustainability needs - and the output gap - to measure cyclical stabilisation needs. According to the Commission, concerns about fiscal sustainability call for rebuilding fiscal buffers in the five highly indebted countries (Belgium, Spain, France, Italy and Portugal); no euro area Member State is expected to experience bad economic conditions, and economic growth is set to return marginally above

² The Commission noted also “Excluding Italy, the projected aggregate euro-area fiscal stance in 2019 would be broadly neutral”.

³ “The S1 indicator measures the change in the structural primary balance required over five years (from 2020 to 2024) to bring general government debt to the reference threshold of 60% of GDP in 2033. The S1 indicator represents a stylised measure of sustainability needs”. See footnote 20 in [Commission report 2019](#).

potential growth, in a context of a very accommodative monetary policy. As a result, no stabilisation needs seem to emerge for 2020. The Commission concludes *“A well-designed fiscal expansion in euro area Member States with fiscal scope would enhance their short- and medium-term growth prospects, while supporting the overall euro area economy at a time when highly-indebted countries have to reduce their deficits... The appropriate differentiation of fiscal policies across member States would lead to a broadly neutral fiscal stance at the euro area level in 2020.... Based on unchanged policies, the Commission 2019 spring forecast points to a slightly expansionary fiscal stance for the euro area aggregate in 2020, which would be pro-cyclical...”*

3. The emblematic debate on the Euro area fiscal stance for 2017

In November 2016, the Commission 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”**⁴ that looks at the fiscal policy in aggregate terms. The Commission considered that both the aggregate fiscal stance forecast for 2017-2018, and the aggregate fiscal stance obtained by summing the individual fiscal stances planned by euro area MSs in their draft budgetary plans, were 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 *“set 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.”*

The Commission in the Communication proposed **numerical objectives for the euro area fiscal stance, against the objective of both reducing the euro area output gap and increasing inflation**. More specifically, it proposed a fiscal expansion of 0.5% of 2017 GDP, which would have corresponded to an additional fiscal stimulus of around 50 billion euro; 0.3% would have halved the output gap, whereas 0.8% would have allowed for a full closure of the output gap in 2017. Furthermore, a fiscal expansion of 0.5% would have contributed to close, in 2017, 25% of the gap between the forecast core inflation in the euro area and the objective of 2%.

The Commission underlined that such a fiscal stance would not be the spontaneous result of the application of the rules to each Member State: actually, the current fiscal situation represented a *“clearly sub-optimal repartition of the fiscal adjustment across countries”*. The Commission noted, *“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 provided 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 did not quantify the individual contribution that each Member State should provide to the overall objective: based a fiscal map, it simply identified the Member States with available fiscal space and whose economies would benefit from limited stimulus. Furthermore, it pointed, *“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, in the [Communication on the Draft Budgetary Plans 2017: overall assessment](#), the Commission had noted *“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, detailed the analytical basis for the second [recommendation on the economic policy of the euro area](#) of November 2016 (see table below).

⁴ The Commission published in December 2017 its proposal for a [“European Minister for Economy and Finance”](#)

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 are 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 stated “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 January 2017, the Eurogroup modified the Commission proposal; the [recommendation for the economic policies of the euro area for 2017](#) was then endorsed by the European Council and adopted in March 2017. The table below shows the two texts.

In 2017, the euro area fiscal stance was actually neutral (-0.0326 of potential GDP). Ireland, Slovakia, Malta and Belgium adopted restrictive fiscal stances; Latvia, Estonia, Lithuania, Italy and Greece adopted expansionary fiscal stances (the latter two were the Member States with the highest ratio debt-to-GDP).

Commission proposed recommendation on the economic policy of the euro area for 2017	Council recommendation on the economic policy of the euro area for 2017
<p>The Commission proposed that:</p> <p>" (...) euro area Member States take action, individually and collectively, within the Eurogroup in the period 2017-2018 to...</p> <p>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.</p> <p>Differentiate the fiscal effort by individual Member States by better taking into account:</p> <ul style="list-style-type: none"> • 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: <ul style="list-style-type: none"> ○ (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. <p>Improve the composition of public finances by creating more room for tangible and intangible investment and ensure the effective functioning of national fiscal frameworks."</p>	<p>The Council adopted the following recommendation, thereby modifying the Commission proposal:</p> <p>"... euro area Member States take action, individually and collectively, within the Eurogroup in the period 2017-2018 to ...</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>Pursue fiscal policies in full respect of the SGP, while making the best use of the flexibility embedded within the existing rules."</p>

3. Some academic papers on the “Euro area fiscal stance” and other readings

In spring 2016, the EP asked three academic experts to provide their contribution on the subject “**The Euro-area fiscal stance: definition, implementation and democratic legitimacy**”. The summary of the papers are as it follows.

- [Bénassy-Quéré](#): in her paper, the author noted 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 highlighted 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 proposed 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 proposed 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 noted 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 proposed 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 suggested 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.

In May 2019, the ECON Committee requested three experts to provide an **assessment of the effectiveness of automatic stabilisers to smooth economic cycles in the Euro Area Member States**. Automatic stabilisers are the items on government budgets that are affected by the macroeconomic situation in ways that operate to smooth the business cycle": typical examples of automatic stabilisers are unemployment benefits and progressive taxation. All authors agree that the main challenges relate to strengthening automatic stabilisers and reducing the impact of pro-cyclical discretionary policies in the Euro Area Member States. To this scope, all the three papers call for an improvement of the EU fiscal governance.

- The [paper](#) by Dolls, Fuest, Peichl and Schleef investigates the current level of automatic stabilisers in the Euro area and analyses the effect of automatic stabilisers in preventing pro-cyclical fiscal policies in good and bad times. The authors underlined *"that euro-area fiscal governance needs to be improved and that it is key to build up fiscal buffers in good economic times so that automatic stabilisers can operate freely in prolonged downturns. A better and more credible enforcement of fiscal rules, a strengthening of independent fiscal councils and a fiscal stabilisation instrument at Euro-area level, as elements of a comprehensive reform package for the Euro-area, could lead to better fiscal policy outcomes."*
- In his [paper](#), P. Van Den Noord assesses the working of the automatic stabilisers in the Euro Area as a whole and its Member States, as well as any discretionary fiscal action that may have weakened or strengthened their impact. The author notes *"The econometric analysis (...) provides some evidence that the spending of cyclical windfalls in good times, and its reversal in bad times, is deeply ingrained in the conduct of fiscal policies in Europe. To the extent that automatic stabilisers themselves have triggered these procyclical fiscal responses, their stabilising impact may be questionable. This is all the more problematic insofar as cyclical distress in the Euro Area tends to entail systemic disruption"*, thus concluding that *"the economic cycle in the Euro Area could have been considerably smoother had discretionary fiscal policy been able or allowed to be conducted in a more counter-cyclical fashion – or at least not overruled the automatic stabilisers."* Noord argues that the creation of a supranational buffer fund, to which Member States contribute in good times and can draw on in bad times, might help to mitigate these tendencies, if underpinned by strong political legitimacy, clear rules, automaticity when possible, and solid judgment when needed.
- The [paper](#) by A. Fatas argues that *"Currently, automatic stabilisers are mostly the result of policies that have nothing to do with stabilization. Government size, which is the largest source of automatic stabilisers, or*

progressive taxation, are designed to deal with political and social demands, not stabilization." Fatas` view is that automatic stabilisers work, that there is no evidence on diminishing of their effects and that they remain an effective tool - if properly strengthened - to deal with the next crisis. The author nevertheless notes that just focusing on automatic stabilisers will not be enough, certainly not before the next crisis. His advice is that the EU needs to complement those efforts with a framework that can produce counter-cyclical discretionary fiscal policy, possibly supported with funding at the European level. The author suggests a European system of unemployment insurance, or programs that supports European-level investments or a European-wide funding vehicle for discretionary policies in recessionary times (Euro bonds).

On the implementation of the Stability and Growth Pact, see also the following EGOV papers:

- [Implementation of the Stability and growth Pact](#)
- [Structural budget Balances in EU Member States](#)
- [Comparison of key figures in the Stability Programmes and European Commission spring 2019 forecast](#)

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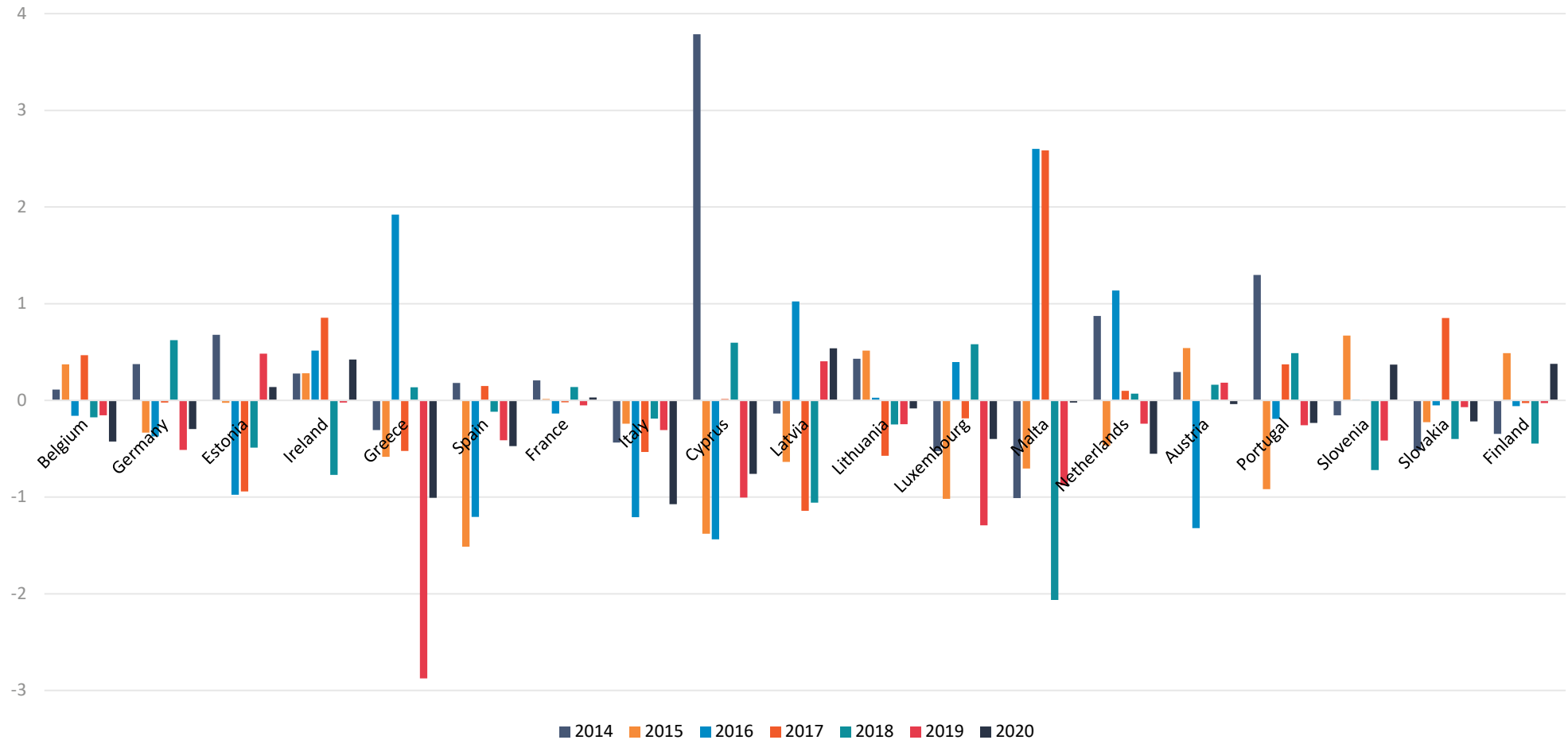
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Annex: Fiscal stance in Euro area and euro area Member States, 2011-2020

	2011	2012	2013	2014	2015	2016	2017	2018	2019*	2020*
Euro area	0,9351	1,5213	0,558	0,1845	-0,3152	-0,3808	-0,0326	0,1444	-0,3305	-0,3453
Belgium	-0,2323	0,5613	0,1585	0,1115	0,3717	-0,1583	0,4683	-0,1745	-0,1555	-0,426
Germany	0,8487	0,8627	0,0317	0,375	-0,334	-0,3728	-0,0213	0,6224	-0,512	-0,2967
Estonia	-0,3805	-0,175	-0,575	0,6773	-0,0241	-0,9772	-0,9415	-0,4888	0,4832	0,1392
Ireland	0,7228	2,1339	2,1778	0,2772	0,2801	0,516	0,8553	-0,7704	-0,0225	0,4219
Greece	5,7372	4,24	1,0306	-0,3073	-0,5832	1,9215	-0,5244	0,1346	-2,8763	-1,0081
Spain	1,4236	3,7625	2,0066	0,1797	-1,5148	-1,2048	0,1499	-0,1185	-0,4131	-0,4742
France	0,9353	0,5845	0,7005	0,2074	0,0135	-0,1356	-0,0193	0,1383	-0,0526	0,0304
Italy	0,4024	2,5236	0,3078	-0,437	-0,242	-1,2077	-0,5341	-0,1898	-0,3078	-1,0742
Cyprus	0,0163	1,9683	3,4761	3,7853	-1,3784	-1,4368	0,0131	0,5958	-1,0054	-0,7596
Latvia	0,2104	1,5729	-0,7533	-0,136	-0,6367	1,0222	-1,1433	-1,0578	0,4034	0,5379
Lithuania	-0,142	1,2113	0,181	0,4304	0,5146	0,0265	-0,5734	-0,2491	-0,2462	-0,0843
Luxembourg	1,0076	1,0756	0,0333	-0,5266	-1,0173	0,3963	-0,1861	0,5819	-1,2929	-0,398
Malta	1,2531	-0,8363	0,9824	-1,0098	-0,7057	2,6022	2,585	-2,0647	-0,8795	-0,0222
Netherlands	0,2349	1,2926	0,5775	0,8718	-0,4691	1,1353	0,0994	0,069	-0,2408	-0,5516
Austria	0,5228	0,6389	0,6368	0,2922	0,5419	-1,3216	0,0003	0,1616	0,184	-0,0392
Portugal	3,2675	3,6916	0,5624	1,2984	-0,919	-0,1915	0,3723	0,4876	-0,2559	-0,2346
Slovenia	0,0755	3,0507	0,8836	-0,1548	0,6697	0,01	0,0013	-0,7216	-0,415	0,3703
Slovakia	3,1976	0,7764	2,0252	-0,5175	-0,2245	-0,0525	0,852	-0,3999	-0,0711	-0,2185
Finland	0,3188	-0,2105	-0,114	-0,3479	0,4875	-0,0602	-0,027	-0,446	-0,027	0,3775

Source: European Commission forecast - Spring 2019 ([Ameco database](#)) *: forecast

Graph: Fiscal stances in euro area Member States, 2014-2020



Source: Commission forecast - Spring 2019 ([Ameco database](#))

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