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STANCE FOR THE EURO AREA

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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE
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OF THE REGIONS**

TOWARDS A POSITIVE FISCAL STANCE FOR THE EURO AREA

1. INTRODUCTION

In the Letter of Intent accompanying the 2016 State of the Union address, President Juncker and First Vice-President Timmermans announced the intention of the Commission to promote "in the next Recommendation on the economic policy of the euro area, a positive fiscal stance for the euro area, in support of the monetary policy of the European Central Bank".

This Communication is adopted together with the Recommendation on the economic policy of the euro area for 2017-2018¹ and sets out the rationale behind its fiscal aspects. Their publication at the start of the annual cycle of the European Semester of economic policy coordination, together with the Annual Growth Survey 2017² and related documents, allows for a timely debate on economic and social priorities at the EU, euro area and the national levels. The outcome of this debate should be reflected in Member States' policies and in particular in their economic and fiscal programmes in spring of next year.

The focus on the need for a positive fiscal stance for the euro area stems from a broader background of a resilient but modest economic growth, as illustrated by the recent Commission Autumn 2016 Economic Forecast³. There has been significant progress in recent years: euro area GDP has recovered its pre-crisis level in real terms since 2015, unemployment has declined to its lowest level since 2010-11 and investment has started to pick up. However, the euro area recovery remains slow, unused capacity in labour and capital is still significant and the overall level of uncertainty is high. Moreover, the subdued and uncertain growth prospects outside the EU suggest little support from exports, if any. The continuation of the expansion in the euro area would thus need to rely increasingly on domestic demand.

Monetary policy has been supportive of growth in recent years, but this is less the case for fiscal policy. Over 2011-2013, the aggregate fiscal stance was contractionary as many Member States engaged in fiscal consolidation to preserve their access to the markets at the height of the sovereign debt crisis. While this dampened growth, it was seen as necessary to safeguard financial stability in unprecedented circumstances and to respond to the risk of contagion across the euro area, which could have resulted in even worse scenarios. In 2014-2015, the aggregate fiscal stance turned broadly neutral and then slightly expansionary in 2016, but it is expected to be broadly neutral again in 2017.

This situation partly highlights the limits of the EU's fiscal framework⁴. First, the EU's current fiscal framework contains no rules or instruments to directly manage the aggregate fiscal stance of the euro area, which is a key difference when compared to unified currency areas across the world. The Recommendation on the economic policy of the euro area is becoming a source of reference to guide efforts, but its effectiveness ultimately depends on the individual and collective willingness of the Member States to follow through.

¹ See COM(2016) 726 final, 16.11.2016.

² See COM(2016) 725 final, 16.11.2016.

³ The Forecast is available at: http://ec.europa.eu/economy_finance/eu/forecasts/2016_autumn_forecast_en.htm

⁴ See also the chapter on the "euro area fiscal stance" of the European Central Bank's Economic Bulletin of June 2016.

Second, the rules of the Stability and Growth Pact are essentially designed to prevent excessive levels of deficit and government debt⁵. They foresee more stringent and binding mechanisms for the Member States which are away from their medium-term budgetary objective, also as a way to help them regain room for macroeconomic stabilisation. However, for those Member States which have achieved their fiscal goals and/or have more fiscal space to act, the tools of the European Semester can only recommend, not enforce, more expansionary fiscal policies. This reflects what is sometimes described as an asymmetry of the EU fiscal framework: the rules can proscribe high deficits (also to avoid high debt) but they can only prescribe the reduction of budgetary surpluses, without imposing it.

Given the need to support the ongoing recovery, and to overcome the risk of a "low growth, low inflation" trap, this Communication sets out the case for a significantly more positive fiscal stance for the euro area 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 current situation is sub-optimal in at least two respects. First, in light of the latest economic and budgetary data, a full delivery of the fiscal requirements contained in the country-specific recommendations of the Council would lead, on aggregate, to a moderately restrictive fiscal stance for the euro area as a whole in 2017 and 2018, while the economic situation would seem to call for an expansionary fiscal stance in the present circumstances.

Second, 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. A more collective approach is needed to overcome the risk of a "lose-lose" scenario for the euro area as a whole.

In moving towards such a positive fiscal stance, there are a number of economic and legal limitations to take into account, and possible trade-offs to be acknowledged. Moreover, this Communication stresses the crucial need to improve the quality of public finances with a view to maximising their impact on jobs and growth, as well as social fairness, not just at national level, but also by looking at the euro area as an aggregate.

A number of conclusions are drawn here and the more immediate policy implications are presented in the proposed Recommendation on the economic policy of the euro area for 2017-2018, which is published alongside this Communication.

⁵ These rules were significantly strengthened over 2011-2013 as a response to the financial and sovereign debt crises.

Box 1: The euro area fiscal stance

While there is no universally accepted definition, the "fiscal stance" is usually understood as the orientation given to fiscal policy by governments' discretionary decisions on tax and expenditure. Traditionally, the fiscal stance is captured by the change in the structural primary balance (i.e. the budget balance corrected for the impact of the economic cycle, non-permanent measures and interest payments), although other indicators can also be used to characterise it (such as indicators based on expenditure growth net of new revenue measures). Depending on whether the government decides to support, reduce or leave unchanged the impact of public finances on the real economy – via the increase/reduction of spending, net of new tax measures – the fiscal stance is considered "expansionary", "contractionary" or "neutral", respectively.

Together with monetary policy, fiscal policy plays a role in the stabilisation of the macroeconomic environment, while also serving broader goals in terms of fiscal sustainability and redistribution functions. The orientation of the fiscal stance determines the role that fiscal policy plays in the economic cycle, which can be more or less pro- or counter-cyclical depending on the circumstances.

When looking at the euro area as a whole, it should be noted that while monetary policy is conceived and designed as a single instrument, the overall fiscal policy is the result of the aggregation of 19 individual fiscal policies. The tools of the European Semester and the rules of the Stability and Growth Pact have long provided direction for action at national level but, apart from the recent role assumed by the Recommendation on the economic policy of the euro area, coordination of action has been limited so far, and the situation and challenges of the euro area have not been easily factored in. In particular, whether the aggregation of national fiscal policies results in a euro area fiscal stance which is appropriate and consistent with monetary policy, is still largely random. This issue is particularly relevant when monetary policy interest rates reach a "zero lower bound" (see Annex 2).

The discussion on the appropriate fiscal stance for the euro area is a key aspect of the Commission's efforts to reinforce the debate on the general interest of and collective responsibility for the euro area, as part of Stage 1 of the follow-up to the Five Presidents' Report on Completing Europe's Economic and Monetary Union ("deepening by doing")⁶.

2. THE MIXED ECONOMIC ENVIRONMENT CALLS FOR A POSITIVE FISCAL STANCE

Compared to the pre-crisis period, the medium-term growth potential of the euro area has virtually halved. This is in part linked to demographic and broader developments but it also reflects what are known as the "hysteresis effects" resulting from a crisis: the economy's weak performance over a prolonged period of time can degrade physical capital and the productivity and participation of the workforce, to such an extent that it permanently reduces the growth potential⁷. As highlighted in the Annual Growth Survey 2017 and in the Recommendation on the economic policy of the euro area, lifting the EU's growth potential requires first and foremost structural policies to boost employment and productivity, but responsible growth-friendly fiscal policy also has a role to play, notably at this point in time.

⁶ See Report at: https://ec.europa.eu/priorities/sites/beta-political/files/5-presidents-report_en.pdf

⁷ Typical examples include the loss of skills resulting from high and prolonged levels of unemployment and the build-up of large investment gaps, as experienced in Europe.

The current economic outlook is mixed, with the recovery proceeding steadily since 2013, but failing to accelerate. The GDP of the euro area is now beyond its pre-crisis level but the recovery remains slow, with continued uncertainty surrounding its strength and evidence suggesting that there is still significant untapped potential in the economy. Inflation also remains persistently low despite unprecedented monetary policy measures. In addition, downside risks abound. The euro area's very large external surplus still hides broader macroeconomic imbalances. Unemployment is falling but remains at very high levels in some Member States. Productivity growth and wage growth remain subdued. New sources of uncertainty have emerged with the result of the UK's referendum on EU membership and other geopolitical developments. The above emphasises the need to strengthen domestic sources of growth.

As the European Central Bank (ECB) is using its monetary policy tools extensively, there is widespread acceptance that monetary policy cannot take the full burden of macroeconomic stabilisation, and that responsible growth-friendly fiscal policy needs to play a bigger role in supporting the recovery of the euro area. This is a concern shared by the global community: at its recent meetings, the G20 re-iterated its members' commitment to a three-pronged growth strategy, with the September 2016 statement saying "we are determined to use all policy tools – monetary, fiscal and structural – individually and collectively to achieve our goal of strong, sustainable, balanced and inclusive growth"⁸.

There is both a need and a window of opportunity to act on the fiscal front at this precise juncture, also to rebalance the overall policy mix of the euro area. Actual and expected inflation expectations continue to fall short of the definition of price stability set by the ECB (understood as inflation below but close to 2% over the medium term). Together with the pursuit of structural reforms and a strong focus on investment, fiscal policy has to contribute more directly to domestic demand, supporting the recovery and moving out of the low inflation territory. Such a pick-up in inflation can also contribute to the normalisation of interest rates, with a beneficial impact on the remuneration of savings and more generally on the functioning of the financial sector, which still has to deal with the debt legacy inherited from the crisis.

Given the particular circumstances, the macroeconomic impact of fiscal policy is likely to be stronger than in normal times. The effectiveness of fiscal policy as a stabilisation tool depends on the overall economic environment in which it is used. Given the fact that monetary policy is at the "zero interest floor" (or "zero lower bound"), the impact of fiscal policy measures both on the real economy (the "multiplier" effect) and on other countries' economies (the "spillover" effect) are larger than would otherwise be the case⁹, for instance if interest rates were high or at risk of rising fast, and that public stimulus would risk to crowd

⁸ G20 Leaders' Communiqué Hangzhou Summit, 4-5 September 2016.

⁹ The spillover effect of fiscal stimulus in 'core' EU Member States is generally found to be weak in normal times. However, this may not hold true at the current juncture with persistently very low inflation and interest rates. In particular, public investment in surplus countries could have significant positive GDP spillovers to the rest of the euro area (see Annex 2).

out private investment (see Annex 2). Moreover, the current context of low interest rates results in significantly reduced costs of financing or refinancing of public budgets.

If well designed, notably in combination with reforms and support to investment, a more active fiscal policy today can contribute to a faster reduction in unemployment in the short run, but also to lift the medium-term (potential) growth in the euro area. There is still considerable slack in the economy at this point in time and a key challenge is to avoid a situation of "low growth, low inflation" from becoming entrenched. There is also significant "reform fatigue" after years of crisis: the capacity to initiate and carry out major structural reforms may entail some costs for public finances in the short-term but if successful, such reforms can have direct long-term positive budgetary effects, including by raising potential growth. In addition to supporting recovery at home, a more supportive fiscal policy would also generate positive spillovers to the global economy, by contributing to lower the euro area's current account surplus, thereby also helping to tackle global imbalances.

Recent initiatives at EU level contribute to maximising the impact of public finances on the real economy. With its focus on leveraging private funds in economically viable and sustainable investment projects, the Investment Plan for Europe contributes to tackling the investment gap accumulated during the crisis years¹⁰. The combination of the European Structural and Investment Funds and of the European Fund for Strategic Investments is particularly promising in providing new innovative financial instruments which maximise the economic impact of every public euro invested. Progress with the completion of the Banking Union and of the Capital Markets Union¹¹ are also essential to diversify sources of financing to the real economy and thus to relieve pressure on public finances. The focus, as part of the European Semester of economic policy coordination, on pursuing structural reforms in support of investment (the so-called "third pillar" of the Investment Plan for Europe) is also essential to maximise the effectiveness of fiscal policy.

3. THE FISCAL STANCE OF THE EURO AREA TODAY

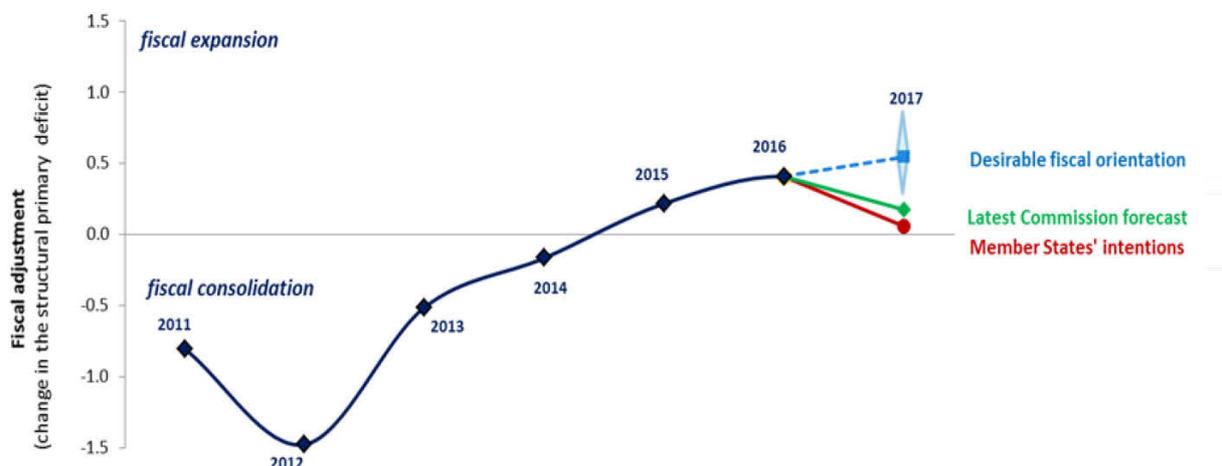
To assess the current situation, it is important to consider the euro area as a single entity, as if there were a Finance Minister for the euro area as a whole and to look at its fiscal policy in aggregate terms. This is the approach taken in this section.

Overall, following the significant fiscal consolidation in 2011-2013, the euro area fiscal stance is estimated to be broadly neutral over 2014-2017 (see graph below). The euro area fiscal stance was contractionary in the period 2011-2013, at a time when the economy was deteriorating. The fiscal stance became broadly neutral in 2014-2015 and slightly expansionary 2016, against the background of a recovery. For 2017, both the aggregation of draft budgetary plans (referred to in the graph as "Member States' intentions") and the Commission Autumn 2016 Economic Forecast point to a broadly neutral fiscal stance again.

¹⁰ The Commission proposed on 14 September 2016 to extend the duration of the European Fund for Strategic Investments (EFSI) and to raise its investment target to at least EUR 500 billion until end-2020, and EUR 630 billion by 2022.

¹¹ See COM(2016) 601 final, 14.9.2016.

Euro area fiscal stance over 2011-2017



Note: This graph illustrates the fiscal stance of the euro area, i.e. the orientation of fiscal policy at an aggregate level. This is measured by the change in the structural primary balance (see also Box 1). A positive value corresponds to a fiscal deficit which is widening (which contributes to a "fiscal expansion"), while a negative value corresponds to a fiscal deficit which is narrowing ("fiscal consolidation"). The aggregate does not include Greece, which is in a stability support programme.

In light of the slow recovery and risks in the macroeconomic environment, there is a case for a moderately expansionary fiscal stance for the euro area at this point in time. Based on estimates from the Commission services, a fiscal expansion of up to 0.5% of GDP at the level of the euro area as a whole is considered desirable for 2017 in the present circumstances¹². This figure results from an assessment of the situation of the levels of economic activity, spare capacity, unemployment and inflation. It is a pragmatic and prudent target in a wider range of estimates: such an expansionary fiscal stance would reduce the share of unused productive capacity in the euro area, while supporting monetary policy¹³ and avoiding unnecessary overheating of the economy.

While the direction is clear, the exact target can be considered within a range and requires judgement. A fiscal expansion of 0.3% would be the lower bound of the range: this would contribute to ensuring that the euro area halves its output gap in 2017¹⁴, while being broadly compatible with the objective of fiscal sustainability. However, such a stance may not be ambitious enough, especially since the estimates of the output gap are surrounded by uncertainty, which may result in underestimating the need for stabilisation in the euro area. By contrast, a fiscal expansion of 0.8% would represent an upper bound: it would allow for the closure of the output gap already in 2017. However, such a stance may be overly

¹² Such a fiscal expansion would correspond to an additional fiscal "stimulus" of around 50 billion euros for the euro area as a whole in 2017, compared to the "business-as-usual" scenario estimated in the latest Commission Forecast. This amount corresponds to the increase in the structural deficit (including interest payments) to reach the desirable fiscal stance.

¹³ An expansionary fiscal stance of 0.5% would also contribute to close a fourth of the gap between the forecast core inflation in the euro area and the objective of 2% inflation in 2017.

¹⁴ The output gap is the difference between the level of actual economic output and its potential.

expansionary, since it may fuel undesirable overheating in some Member States and would be at odds with the goal of preserving the sustainability of public finances.

The issue today is that even if economists can point at a desirable fiscal stance for the euro area in order to combine macroeconomic with fiscal sustainability concerns, such a fiscal stance will not be the spontaneous result of the application of the rules to each Member State. In light of the latest economic and budgetary data, a full delivery of the fiscal requirements contained in the country-specific recommendations adopted by the Council in July 2016 would imply, on aggregate, a moderately restrictive fiscal stance for the euro area as a whole in 2017 and similar trends can be estimated for 2018¹⁵ (see Graph 4 in Annex 1). This is without factoring in the flexibility which exists within the rules to take account of changing economic circumstances¹⁶.

In discussing the appropriate fiscal stance for the euro area today, it is also important to stress that the current fiscal situation conceals a clearly sub-optimal repartition of the fiscal adjustment across countries at this point in time. Member States are in very different situations in terms of fiscal space or consolidation needs (see Graph 3 in Annex 1). Looking at 2017, Member States with further consolidation needs would seem to expand further, which could fuel concerns about the sustainability of their public finances (see Graph 5 in Annex 1). Conversely, Member States which enjoy fiscal space do not necessarily use it. This may create concerns about the need to increase investment and strengthen their growth fundamentals, but also about the capacity to support the recovery of the euro area as a whole.

4. ECONOMIC AND LEGAL LIMITATIONS TO ACHIEVE A POSITIVE FISCAL STANCE

Pursuing a positive fiscal stance at the aggregate euro area level comes with both economic and legal constraints. The former relate essentially to the need to balance macroeconomic stabilisation needs in the short term with the preservation of the sustainability of public finances in the medium run, as part of a broader economic agenda. The latter refer to the operation of the EU fiscal surveillance framework in certain circumstances. Both sets of constraints reveal possible trade-offs, which ultimately require political judgement.

The 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 (see Graph 3 and Graph 8 in Annex 1). In those Member States, a too active fiscal policy may exacerbate confidence problems in the sustainability of public finances and in the sustainability of the recovery, rather than address them. This would notably be the case if the strategy were not accompanied by reforms and

¹⁵ The fiscal requirements and resulting fiscal stance for the euro area in 2018 are expected to be broadly similar to those for 2017 since they depend on how far a country is from its medium-term fiscal objective, the economic situation and the level of debt, which are not forecast to change significantly.

¹⁶ See COM(2015) 12 final, 13.1.2015.

policies ensuring that the impact is indeed passed on to the real economy, if it proved unable to reduce significantly debt levels and/or if it led interest rates to increase.

Fiscal sustainability remains a priority, notably for specific Member States, but challenges have receded significantly since the peak of the crisis, and it may not be a major source of risks for the euro area as a whole in the short term. The situation of public finances had deteriorated sharply over 2008-2012, with levels of government debt rising on average from 60% of GDP to more than 90% in the euro area. In most cases, the large increase in debt in the recent past is the result of bank recapitalisation and low growth in nominal GDP, not of fiscal profligacy. Public debt is now receding slightly from its peak of 92% in 2015 but levels remain very high, for instance in the seven Member States above the euro area average: Greece (182% of GDP in 2016), Italy (133%), Portugal (130%), Cyprus (107%), Belgium (107%), Spain (99%) and France (96%). In parallel, the aggregate public deficit for the euro area has come down from above 6% of GDP in 2010 to less than 2% in 2016, and it is projected to fall further.

As seen above, a more positive fiscal stance would seem appropriate given the state of the recovery but it cannot be assumed for 2017-2018. The current EU fiscal framework focuses essentially on defining Member States' specific requirements, without capturing fully the euro area implications. Under the rules of the Stability and Growth Pact, the logic is that the Member States are best able to let automatic stabilisers play their role fully once the budget has reached its medium-term objective (MTO), and that some fiscal consolidation is expected until this is the case. Having done the necessary fiscal adjustments, those Member States that achieve their MTOs and have fiscal space are assumed to choose to support domestic demand, in their own interest and more generally, but they are only invited to do it: the EU's annual country-specific recommendations contain clear policy guidance about this, but no quantified fiscal requirements are addressed to those Member States. For 2017, the recommendations made under the Stability and Growth Pact request many Member States to continue consolidating their budgets, either to correct excessive deficits (in the corrective arm of the Pact) or to achieve their medium-term objectives (in the preventive arm).

Reaching the right policy mix for the euro area is less straightforward in the absence of a centralised budget which could play a more active role. Even if the European Structural and Investment Funds can play an important role in supporting domestic demand¹⁷, the current EU budget is comparatively small, at about 1% of EU GDP, and not specifically targeted to the needs of the euro area, with limited possibilities to adjust it from one year to

¹⁷ These Funds represent a very significant share of total public investment in many Member States, and more than 1% of GDP in seven euro area Member States in a given year. Moreover, the fact that they provide a regular stream of financial support means that they can also play a stabilisation function, especially for small economies more exposed to shocks.

the next. That element was also highlighted by the Five Presidents' Report on Completing Europe's Economic and Monetary Union.

5. THE COMPOSITION AND QUALITY OF THE FISCAL STANCE MATTER

Promoting a positive fiscal stance is not just a question of the direction and size of the budget balance, but also very much of the composition of the public finances behind it. In addition to the issue of the repartition of the adjustment across Member States mentioned above, it is thus important to stress the issue of the quality of public expenditure and taxation.

The EU's country-specific recommendations stress ways to design responsible, growth-friendly fiscal policy and identify some of the priority areas that would benefit from increased/better spending or a shift in taxation at national level. This is particularly important for the countries which need to address growth weaknesses and/or long-term fiscal sustainability risks. However, in spite of guidance given, there is evidence that the composition of the fiscal consolidation in the aftermath of the crisis has been sub-optimal in many Member States. In particular, notably in Member States which already had high revenue-to-GDP ratios, fiscal consolidation has relied excessively on tax increases, which have depressed growth (see Graph 6 in Annex 1). At the same time, government investment spending, which was severely cut amidst the consolidation efforts in the post-crisis years, remains compressed (see Graph 7 in Annex 1).

Reforming pension and health-care systems can further enhance the quality of public finances. Pension and health care constitute the bulk of public finances in most Member States and the further modernisation of welfare systems is a shared priority in the light of the new challenges - but also opportunities - brought about by changes in family structures, increased life expectancy and the digitisation of the economy. The Eurogroup has recently agreed on a number of principles that aim to increase the sustainability of pension systems. It has also invited the Commission to take them into account in its surveillance processes and to explore the development of appropriate benchmarks on that basis¹⁸.

Improvements in national fiscal frameworks can also foster the growth-friendliness of public spending, not least through the setting up of efficient spending reviews and stronger public finance management at all levels of government. Such tools and practices are very helpful in bolstering the credibility of fiscal policy, by internalising the EU framework in

¹⁸ The Eurogroup statement on common principles for strengthening pension sustainability can be found at: <http://www.consilium.europa.eu/en/press/press-releases/2016/06/16-eurogroup-pension-sustainability/>

national policy settings and, thereby, enhancing the sense of ownership. The principles for the conduct of spending reviews recently endorsed by the Eurogroup provide a very useful starting point¹⁹.

Another important priority for most Member States is to make certain parts of their public finances more responsive to smoothen cyclical developments, and thus increase their macroeconomic stabilisation function. There are many aspects of public finances which have shock-absorbing and counter-cyclical properties, such as unemployment insurance and social assistance systems, or the progressive nature of income tax systems.

Several instruments of the Investment Plan for Europe offer ways for Member States to magnify the financial firepower of their public interventions into the real economy, with benefits at home and across borders. This is for instance the case if Member States choose to make better use of innovative financial instruments under the European Structural and Investment Funds. This is also the case where Member States decide to contribute to the deployment of the European Fund for Strategic Investments (EFSI). For instance, guarantees to the EFSI are a particularly effective way for Member States with fiscal space to make good on their commitments to do their part to support the recovery in the euro area²⁰.

The success of any stimulus aimed at boosting investment will depend on the availability of quality projects. At European level, a new European Investment Portal provides examples of European investment projects of interest. At national level, it is important to progress towards national infrastructure plans agreed and coordinated among all levels of administration, in order to ensure a stable pipeline of high-quality projects.

6. CONCLUSION

This Commission has put jobs, growth and social fairness at the core of its agenda. It has focused its action on a “virtuous triangle” of economic policy combining the re-launch of investment, the pursuit of structural reforms and responsible fiscal policies. It has clarified and made use of the flexibility which exists within the rules of the Stability and Growth Pact, to take better account of the economic cycle and to provide incentives for structural reforms and investment. It has provided concise guidance in its country-specific recommendations.

At a stage where the recovery remains fragile and uncertainty is high, a significantly more positive fiscal stance is warranted for the euro area. This is important to fuel the real economy, but also to support the monetary policy of the European Central Bank. At the same time, such an orientation should build on the legal framework set by the Stability and Growth

¹⁹ See: http://www.consilium.europa.eu/en/meetings/eurogroup/2016/09/spending-reviews_commission_note_pdf

²⁰ Contributions to the EFSI can take the form of cash or guarantee. While cash contributions, unlike guarantees, are deficit- and debt-increasing in statistical terms, they are neutralised for the purpose of assessment of compliance with the Stability and Growth Pact.

Pact and take account of broader fiscal sustainability concerns, which is particularly relevant for certain Member States. This new orientation should be part of an overall rebalancing of the priorities and policy mix of the euro area, including a greater focus on the quality of public finances and the implementation of structural reforms.

In the absence of a fiscal stabilisation function, there is no in-built mechanism at EU level to deliver a fiscal stance which is appropriate for the euro area as a whole while being well balanced at Member States' level. Applying the rules of the Stability and Growth Pact blindly, by disregarding the elements of flexibility they contain, would also not result in a satisfactory outcome, especially not in the current circumstances. The design of a positive fiscal stance is thus essentially a matter for the collective responsibility of the euro area Member States.

Given the need to act at the present juncture, the Commission confirms its intention:

- To support the Eurogroup, the Council and the European Council in their discussion on the Recommendation on the economic policy of the euro area for 2017-2018. The Recommendation should set out an overall direction for the euro area fiscal stance and specify the repartition of efforts expected by the different categories of Member States, not only in the light of their own economic and fiscal situation, but also of the euro area aggregate. Member States in the Excessive Deficit Procedure and others still needing to progress towards their medium-term budgetary objective should continue to do so, as recommended to them. Member States with fiscal space should be encouraged to carry out a more expansionary fiscal policy, including by making full use of the tools of the Investment Plan for Europe in order to maximise the impact on the real economy, such as guarantees to the European Fund for Strategic Investments.
- To continue to apply the Stability and Growth Pact with the economic reading which the rules foresee, including to take account of the challenges and priorities of the euro area as a whole. This approach is also reflected in the opinions on the 2017 Draft Budgetary Plans of euro area Member States adopted today²¹.
- To engage with each euro area Member State, in the context of European Semester of economic policy coordination, to better reflect euro area challenges and priorities into national policies. This will notably be the case for the Member States subject to in-depth reviews as part of the Macroeconomic Imbalances Procedure. The country reports next February will be used to track progress for each Member State.
- To continue to use all EU-level instruments, such as those of the Investment Plan for Europe, to maximise the impact of public spending at all levels of government, including cross-border, and to reinforce synergies between EU and national strategies.
- To re-assess the situation regularly in the context of the European Semester 2017 and of its future economic forecasts. The Commission stands ready to use all the available options under the EU fiscal framework in case the recovery of the euro area remains

²¹ See COM(2016) 730 final, 16.11.2016.

subdued or downside risks materialise. Conversely, risks of overheating and pro-cyclical policy should be averted, if the recovery becomes stronger than expected.

This Communication focuses essentially on the specific situation of 2017-2018, but it is part of the broader effort of the Commission to promote the collective interest of the euro area and of its Member States, and to deepen Europe's Economic and Monetary Union. Since the Five Presidents' Report and follow-up Communication from the Commission²², there has been some progress in "deepening by doing". In particular, a European Fiscal Board was recently set up, which will regularly advise the Commission in the future on the fiscal stance appropriate for the euro area and on the application of the EU fiscal framework.

The Commission will come up with further orientations on the future of the Economic and Monetary Union as part of its White Paper on the future of Europe in March 2017.

²² See COM(2015) 600 final, 21.10.2015.