EU Won’t Reject French, Italian Budgets
Spending Plans Not ‘Egregiously’ Off Target After Paris, Rome Pledged Cuts

French President Francois Hollande, left, talks with Italian Prime Minister Matteo Renzi, right, at an EU summit in Brussels last week AGENCE FRANCE-PRESSE/GETTY IMAGES

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BRUSSELS—European Union authorities said they have decided not to raise serious objections to next year’s French and Italian budgets, defusing an immediate standoff that could have led to swift fines against Paris and Rome.

The move hands final decisions on the French and Italian budgets to the new batch of commissioners at the European Commission, the EU’s executive arm, who take office Saturday.

The new commissioners may still seek more austerity measures from Paris and Rome to hit budget targets that the governments agreed to in July, but any additional spending cuts or tax increases sought by the EU will likely be minor, European officials say.

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The budget proposals have reinvigorated a debate on government austerity in Europe. With eurozone unemployment stuck over 11% and the risks of another recession rising, Paris and Rome have been arguing that the currency area should slow the pace of deficit cuts. The budgets they submitted to Brussels earlier this month contain almost no austerity measures for next year.

Both governments on Monday pledged a small number of additional cuts, enabling EU officials to determine that the budgets were no longer egregiously off target. Before the adjustments, the commission was preparing to determine that the French budget was in “serious noncompliance” with the bloc’s budget rules while deeming the Italian budget a borderline case, officials said.

Commission officials have been determined to stand behind the bloc’s new system for overseeing national budgets, created to help prevent another debt crisis like the one that nearly split apart the eurozone a few years ago.

Though the rules allow budgets to miss their mark because of unexpected economic weakness, EU officials argued that the French and Italian budgets as first proposed were too far off track to qualify for that flexibility. They worried that backing down would show that large member states can shirk the bloc’s budget rules with no consequences, as they have in the past.

The rise of anti-EU parties—such as Marine Le Pen’s National Front in France and Beppe Grillo’s Five-Star Movement in Italy—also loomed large in the Brussels debate. Tough new austerity mandates from the commission could have undermined the center-left governments of French President François Hollande and Italian Prime Minister Matteo Renzi.

EU officials still have concerns about both budgets, particularly France’s. But with just a few days left in office, the departing commissioners believe they have “limited political legitimacy” to confront France with a decision that could roil eurozone bond markets, a senior EU official said.

Jyrki Katainen, the European economics commissioner, said on Tuesday that he hadn’t found examples of “serious noncompliance” in the draft budgets. The commission had also raised concerns about budgets submitted by Austria, Slovenia and Malta, officials say.

“After taking into account all of the further information and improvements communicated to us in recent days, I cannot immediately identify cases of ‘particularly serious noncompliance’ which would oblige us to consider a negative opinion at this stage in the process,” Mr. Katainen said in a statement.
France and Italy aren’t off the hook yet. The commission next month will issue recommendations for governments, which will be discussed at a meeting of eurozone finance ministers on Nov. 21. Next week, the commission will publish its official forecasts of the governments’ budget deficits for next year, providing the baseline for its analyses of the national budget plans.

“If we don’t send them a red card now, that doesn’t mean we won’t send them a yellow card later,” the senior EU official said.

Until Monday, the French government had repeatedly refused to make any changes to taxes or spending in the 2015 budget. Then it proposed hundreds of millions of euros in new tax-raising measures and said it would benefit from lower-than-anticipated debt-service costs.

“We have had a constructive dialogue with the European Commission and we will continue to do so. Working collectively we must find the means for an economic recovery in the whole of the eurozone,” French Finance Minister Michel Sapin said on Tuesday.

The opposition to Mr. Hollande’s ruling Socialist Party was quick to criticize the tweaks his government proposed to the commission. “These changes are phony,” former conservative Prime Minister François Fillon said in a radio interview on Europe 1. “The truth is that this government isn’t cutting spending and is raising taxes.”

In Italy, Mr. Renzi’s government said on Monday it would use a €3.3 billion ($4.18 billion) reserve initially earmarked for tax cuts to help meet the EU budget requests. A further €1.2 billion from minor budget adjustments will also be redirected to satisfy Brussels.

After the additional budget measures, the Italian government on Tuesday cut its target for next year’s deficit to 2.6% of gross domestic product from a previously planned 2.9%.

“The acknowledgement that our budget is substantially coherent with EU rules means that Europe, too, is following the path of growth and job creation,” Italy’s Economy Minister Pier Carlo Padoan said Tuesday. He stressed that the additional budget measures remain in line with Rome’s main objective to spur a recovery with a mix of tax and spending cuts.

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