CHAPTER 11

The Impact of the EU on National Fiscal Governance Systems

László Jankovics, Leire Ormaetxea Igarzabal, and Ştefan Ciobanu

11.1 Introduction

National fiscal frameworks (NFFs) represent a set of domestic arrangements (i.e. numerical rules, medium-term planning, forecasting, independent fiscal institutions (IFIs), budgetary coordination mechanisms, etc.). The rationale for having NFFs in place is that they enhance the predictability and transparency of domestic budgetary planning by establishing

The views expressed are solely those of the authors and do not necessarily represent the official views of the European Commission. The information used in this chapter and the related analyses have been prepared with a reference date of end-2019.

L. Jankovics (✉) • L. O. Igarzabal • Ş. Ciobanu
DG ECFIN, European Commission, Brussels, Belgium
e-mail: Laszlo.JANKOVICS@ec.europa.eu; Leire.ORMAETXEA-IGARZABAL@ec.europa.eu; Stefan.CIOBANU@ec.europa.eu

M. Landesmann, I. P. Székely (eds.), *Does EU Membership Facilitate Convergence? The Experience of the EU's Eastern Enlargement - Volume II*, Studies in Economic Transition,
https://doi.org/10.1007/978-3-030-57702-5_11

incentives for budgetary discipline and constraints on policy discretion. As the EU fiscal framework does not operate in a vacuum, effective NFFs facilitate the respect of the Member States' European commitments as per the Stability and Growth Pact (SGP).

This chapter will look into a specific aspect of institutional convergence: the development of NFFs. It is worth recalling that at the time of the Eastern accession waves, there were no specific common requirements defined in this policy domain. It implied that up until the eruption of the Great Recession and the launch of the economic governance revamp process, there was only moderate progress in budgetary planning and reporting in the EU-11 countries, triggered chiefly by the annual requirement of preparing Stability and Convergence Programmes and submitting the bi-annual fiscal notifications. Thereafter, a clear reform acceleration ensued in the region, most notably as regards the (re-)design of domestic numerical rules, the guiding role of medium-term plans and the establishment of national IFIs. It has led by now, in many aspects, to a similar state of advancement compared to the 'old' Member States (which, by the way, also made significant improvements in the meantime). The assumption of this general catching-up is broadly corroborated by various indicators, notably the strength indices calculated by the Commission on the basis of its Fiscal Governance Database (see details in the following sections).

The remainder of this chapter is structured as follows. Section 11.2 will provide a brief account of the theoretical and empirical literature on the rationale and potential benefits of sound fiscal governance arrangements and the relevant EU legal provisions which were prominently inspired by these insights. Subsequently, there will be stylised overviews on the main pillars of NFFs in the EU-11 countries, namely numerical rules, medium-term budgetary frameworks and IFIs. The next section will zoom in on the issue of IFIs by discussing the observable patterns of their main functions in a region where the starting point was very rudimentary—only one IFI (Slovenia's Institute of Macroeconomic Analysis and Development (IMAD)) predated the EU accession—and the diversity of national arrangements could probably be best captured. Finally, Sect. 11.5 will conclude.

11.2 Literature Review and EU Legal Requirements

Discretionary fiscal policy has been consensually identified in the economic literature as suffering from two interrelated shortcomings: deficit bias (i.e. the tendency for government to run budget deficits above what is permissible) and pro-cyclicality. The persistent deviation from an optimal policy path, resulting in sustained debt accumulation, has primarily been explained by political economy considerations,[1] ranging from fiscal illusions by an ill-informed electorate to the time inconsistency phenomenon, and more recently including models on indebtedness as a strategic tool by incumbents to limit the fiscal space of a successor government. Partly linked to this, the convincingly documented pro-cyclicality of fiscal policy, especially during good economic times,[2] entails two important drawbacks. First, pro-cyclical policies tend to exacerbate the volatility of output and employment, thereby depressing the accumulation of capital via increased uncertainty. Second, they lead to insufficient elbowroom in cyclical downturns, essentially undermining the stabilisation function of fiscal policy.

Rule-based fiscal policy as embodied by numerical rules was first typically deployed in order to address the above deficiencies. In terms of empirical evidence, based on an EU dataset over the period 1990–2005, Debrun et al. (2008) found statistically significant and economically large impacts of fiscal rules on budgetary aggregates, controlling for other factors. In their baseline specification, when fiscal outcomes were measured by the cyclically adjusted primary balance (CAPB) and the design of fiscal rules by the European Commission's Fiscal Rule Index (FRI),[3] a 0.4% of GDP improvement in the CAPB was found for every standard-deviation increase in the FRI in the short term. Nerlich and Reuter (2013) found strong evidence on the positive impact of national fiscal rules in the EU, too: over the period 1990–2012, the CAPB improved by 0.55% of GDP in countries with at least one fiscal rule in place compared with those with no rules.

[1] For a recent survey of the related political economy models, see Alesina and Passalacqua (2015).

[2] See, for example Turrini (2008) for the euro area evidence.

[3] See the detailed explanation of the FRI and its evolution for the regional countries in the next section.

However, a growing awareness of disappointing outcomes in terms of fiscal rule enforcement put the spotlight on the other components of domestic fiscal frameworks as additional features (i.e. not as substitute for fiscal rules). There are an increasing number of studies analysing the effects of specific fiscal characteristics on budgetary performance. Most notably, effective medium-term budgetary planning appears instrumental in sticking to budgetary plans (European Commission 2007), while the quality of domestic budgetary procedures was also shown to contribute to better budgetary performance (Fabrizio and Mody 2006). Finally, national IFIs have also recently emerged as complementary pillars in a comprehensive fiscal framework. In fact, also through their continuous monitoring of public finance developments, IFIs are expected to promote transparency and accountability, thereby reducing information asymmetries and raising the quality of fiscal policy debates.

In terms of empirical evidence for the impact of IFIs, a recent IMF (2017) paper showed that fiscal rules equipped with independent monitoring arrangements were associated with lower sovereign debt financing costs. This result held even for countries with a mixed track record of fiscal responsibility. Furthermore, based on the IMF Fiscal Council Dataset, Debrun and Kinda (2014) empirically investigated whether the observable design of independent bodies possesses a discipline-enhancing power. Overall, they conclude that only well-designed IFIs are associated with better fiscal outcomes and less biased forecasts, so the mere existence of IFIs is not by itself conducive to sound public finances.[4] Specifically, the identified key characteristics for an effective operation are the following ones: (i) independent functioning; (ii) a visible presence in the public debate; (iii) mandate to monitor numerical rules; and (iv) mandate to assess/produce the official macro-fiscal forecasts.

In the context of successive economic governance reform waves and with a view to the benefits outlined in the literature, a number of legislative initiatives at the EU level between 2010 and 2013 provided a significant impetus for the development of national fiscal frameworks (see below). It should be stressed that Member States have retained a significant degree of freedom in terms of designing their own national frameworks (most

[4] The authors stress that even significantly positive correlations should not be interpreted as a causal relation as these may simply reflect deeper, often unobservable factors. Moreover, the limited time span for many of the IFIs in the database may also affect the empirical results.

notably, domestic rules, annual and medium-term planning procedures, and IFIs). Given that existence of some key governance elements in most of the Member States predated the supranational legislation, and also as a recognition of the diversity of national fiscal and administrative settings, there was no attempt to impose a one-size-fits-all model in the EU legislation.

- First, one component of the 'Six-Pack', the Budgetary Frameworks Directive[5] set minimum standards for domestic fiscal governance arrangements in 2011, in an attempt to foster budgetary discipline and to increase national ownership of the EU fiscal rulebook. Specifically, it established essential requirements in the following areas: (i) public accounting and fiscal statistics; (ii) forecasts; (iii) numerical fiscal rules; (iv) medium-term planning; (v) transparency and comprehensive scope of budgetary frameworks. It also introduced a reference to the need for involving IFIs or 'bodies endowed with functional autonomy' in the monitoring of compliance with national fiscal rules.
- Second, the intergovernmental Fiscal Compact[6] was signed in 2012 (it currently binds 22 signatory Member States). It obliges the contracting parties to establish a structural balanced-budget rule, preferably at constitutional level, with a general lower limit of the structural deficit set at 0.5% of GDP. The rule must include an automatic correction mechanism in case of deviation from the deficit target or the adjustment path towards it. It should also be equipped with monitoring arrangements involving designated domestic IFIs. The accompanying common principles proposed by the Commission[7] set minimum independence standards for IFIs in terms of, inter alia,

[5] Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States – OJ of 23.11.2011, L306/41.

[6] The Fiscal Compact is Title III of the intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, signed in March 2012. It requires euro area countries to introduce in the national legislation a balanced budget rule in structural terms, an automatic correction mechanism and an independent fiscal institution to monitor the rule. Bulgaria, Denmark and Romania are also bound by the same requirements on a voluntary basis.

[7] Communication from the Commission: Common principles on national fiscal correction mechanisms (COM/2012/0342 final). Web: https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52012DC0342&from=EN

legal underpinnings for the set-up, nomination procedures for members, access to information and availability of resources.
- Finally, in 2013, one of the 'Two-Pack' Regulations for euro area Member States[8] introduced, among others, the requirement for national medium-term fiscal plans and draft budgets to be based on independently produced or endorsed macroeconomic forecasts. It also extended the requirement of monitoring by independent bodies to all domestic numerical rules in force.

11.3 The Main Fiscal Governance Pillars in the EU-11 Countries

11.3.1 Numerical Fiscal Rules

Numerical fiscal rules consist in permanent constraints on fiscal policy, typically expressed in terms of a summary indicator of fiscal performance[9] like budget balance or debt-to-GDP ratio, to mention some common examples. They are intended to make policy-makers commit to a disciplined fiscal behaviour, thereby improving fiscal sustainability and transparency.

According to the information reflected in the latest vintage (2017) of the Fiscal Governance Database[10] maintained by the European Commission, there was a total of 42 fiscal rules in force in the EU-11 countries in 2017, whereas only 15 had been in place back in 2003. Against the backdrop of a steep rise in the number of rules for the EU as a whole in this period, the increase for the EU-11 subgroup was even more substantial, suggesting that EU membership has brought about significant reforms to the frameworks in these new Member States.

Back in 2003, debt rules were dominant in the EU-11 countries (10 rules, two thirds of the total), followed by budget balance rules (four rules, or under one third) and expenditure rules (just one rule). Data also show that, before the EU membership, the focus of fiscal rules used to be

[8] Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area – OJ L 140, 27.5.2013.

[9] See Kopits and Symansky (1998).

[10] Fiscal Governance in the EU Member States: Numerical Fiscal Rules. Web: https://ec.europa.eu/info/business-economy-euro/indicators-statistics/economic-databases/fiscal-governance-eu-member-states/numerical-fiscal-rules-eu-member-countries_en

on controlling public finances at the local level, as rules targeting the local level constituted more than a half of the rules. Overall, there seemed to be a general approach to use fiscal rules as a constraining device of local governments' debt levels. Only four (20%) of the rules targeted the general government as a whole.

The picture changed markedly in the following years, primarily due to the crisis-prompted requirements set in law at the EU level, such as the 2011 Six-Pack, the 2013 Two-Pack or the intergovernmental Fiscal Compact, but also in relation to some of the EU-11 countries becoming members of the Euro area. The new Member States are bound not only by the Treaty reference values of 3% headline deficit and 60% government debt, but also—as mandated by the EU fiscal framework—by the required adjustment towards their respective medium-term budgetary objective (MTO) and by the debt reduction benchmark, among others.[11] This reality is clearly reflected in the national rules that were adopted in the last decade, some of which mimic these European requirements.

Over 2003–2017, budget balance rules became the most widely used in the EU-11 countries (18 rules, almost half of the total). Importantly, half of those rules were defined in structural terms, which reflect the shift towards an approach to fiscal rules more in line with the revised SGP, largely achieved through the national implementation of Fiscal Compact obligations.[12] The total number of debt rules also went up, resulting from the replacement over the years of some rules at the local level by rules targeting the whole general government, a more encompassing type of debt rule, which is also more in line with the SGP. Overall, by 2017, rules targeting the whole general government, which facilitate a coordinated approach to the management of public finances in a country, came to account for almost 60% of the rules.

Beyond the sheer number of fiscal rules in place, the quality of those rules is equally or even more essential when analysing the strength of the fiscal framework of a country. The European Commission uses its own Fiscal Rules Index (FRI) as a proxy of the quality of a rule, which is then aggregated to produce a country index. The FRI is based on qualitative information on five key dimensions, namely: the legal base of the rule, the extent to which the target is binding, the institution which monitors and

[11] See European Commission (2019) for a detailed explanation on the SGP requirements.

[12] Communication from the Commission: The Fiscal Compact: Taking Stock (C(2017) 1200 final). Web: https://ec.europa.eu/info/sites/info/files/1_en_act_part1_v3_0.pdf

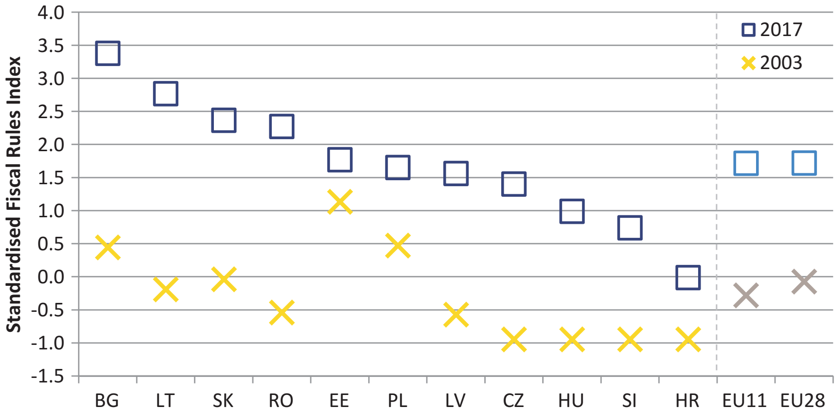

Fig. 11.1 The Fiscal Rules Index for EU-11 in 2017 as compared to 2003. (Source: European Commission's Fiscal Governance Database)

enforces the rule, the forecasting institution, the corrective measures triggered in case of non-compliance and the extent to which the rule is resilient to economic shocks.

Figure 11.1 illustrates how the FRI improved in all EU-11 Member States between 2003 and 2017. In most cases, the improvement is substantial, with only Estonia and Poland showing smaller increases in their indices. The set of fiscal rules in Bulgaria and Lithuania rank the highest in this hierarchy, which admittedly is partly due to the higher number of rules in force, whereas Croatia, Slovenia and Hungary are at the other end of the spectrum. When compared to the EU-28 average FRI, the EU-11 average FRI was lower in 2003, whereas by 2017 the two indices became almost identical, as an indication of the upwards convergence achieved by the EU-11 in terms of fiscal rule strength.

Overall, more and better-designed fiscal rules are now in place in the EU-11 countries than before their accession to the EU. The current rules cover well the scope of general government, are more robust and provide for more detailed corrective action in case they are not complied with while allowing for flexibility in difficult economic times. Not least, the vast majority of rules are monitored by independent fiscal councils, which increases the reputational cost of non-compliance (see also next subsection). All this contributes to a more responsible and predictable approach to fiscal policy for which delivers better in terms of both macroeconomic stabilisation and sustainability of public finances. Undoubtedly, EU membership has been decisive in the development of these features in the newer Member States.

11.3.2 Medium-Term Budgetary Frameworks

Because the effects and implications of discretionary fiscal measures usually extend over multiple years, policy-makers require a medium-term perspective in order to design a sound strategy for the fiscal plans of their respective countries. Medium-term budgetary frameworks (MTBF) constitute institutional policy instruments that allow this extension of the horizon for fiscal policy-making beyond the annual budgetary calendar.[13]

EU requirements attach great importance to having a credible and realistic medium-term planning across the Member States. Going beyond the long-established submission of Stability or Convergence Programmes, more recently provisions conducive to adopting a medium-term approach in every Member State were enshrined in EU law via the Budgetary Frameworks Directive and the Two-Pack. The relevant EU legislation still leaves substantial room for Member States to transpose the measures into their national legal and institutional settings and, consequently, a wide array of MTBF arrangements is now in place across the EU, including within the EU-11 group.

The development of MTBFs in the Member States is reflected as well in the European Commission's Fiscal Governance Database.[14] A dedicated module of the database covers in detail the design of the national MTBFs as of 2006, notably as regards the following aspects: coverage, the extent to which the medium-term plan is binding, the involvement of national parliament, the involvement of IFIs and the level of detail in those medium-term plans (e.g. whether revenue and expenditure projections are broken down by categories, whether alternative macroeconomic scenarios are being taken into account).

In general terms, a similar trend as for the Member States' numerical fiscal rules is observed for MTBFs, that is, an improvement in design across the board, as illustrated by the graph in Fig. 11.2. There was a

[13] See Sherwood (2015) for a detailed overview in EU Member States.

[14] Fiscal Governance in the EU Member States: Medium-term budgetary frameworks. Web: https://ec.europa.eu/info/business-economy-euro/indicators-statistics/economic-databases/fiscal-governance-eu-member-states/medium-term-budgetary-framework_en

notable increase in the MTBF index (calculated by the Commission based on the information in the Fiscal Governance Database) between 2006 and 2017 for all EU-11 Member States with the exception of Czechia (where a marginal decrease of 0.05 points was recorded). Back in 2006, Bulgaria, Romania, Croatia and Hungary still did not have a medium-term plan in place, but adopted one shortly afterwards. Overall, the situation in this subgroup of countries has remarkably improved so that by 2017 a large number of the EU-11 countries were at the EU-28 average or above it (namely, Latvia, Slovakia, Bulgaria, Lithuania, Estonia, Romania and Slovenia). However, in spite of the good progress made, in 2017 the EU-11 index average still remained at a slightly lower level than the overall EU-28.

Having detailed MTBFs that can be actively used as fiscal policy instruments has been another concrete consequence of EU membership that benefitted the EU-11 Member States. As fiscal policy choices usually have effects that extend over various budgetary exercises, the emphasis on medium-term approach creates better pre-requisites for prudent policy-making.

Fig. 11.2 The MTBF Index for EU-11 in 2017 as compared to 2006. (Source: European Commission's Fiscal Governance Database)

11.3.3 Independent Fiscal Institutions

The previously mentioned EU-level legislative initiatives in the area of fiscal governance provided, among others, a significant impetus for IFI development. The number of IFIs has exponentially increased in the recent past: out of the 12 IFIs that were present in the EU-11 at the end of 2018, only the Slovenian IMAD had been active before the global crisis (see Table 11.1).[15] The latest arrivals on the scene are the Slovenian Fiscal Council, which became operational in late spring 2017, and the Czech Fiscal Council, whose members were nominated in January 2018. It should be stressed that while there are considerably more stringent EU legal requirements for euro area Member States in this domain, even this group of countries has retained a significant degree of freedom in terms of designing their own independent bodies.

In terms of independence safeguards, all regional IFIs rely on a statutory base grounded in ordinary legislative provisions or those of higher legal standing (in Estonia, Hungary, Lithuania and Slovakia, IFIs were established through constitutional norms or laws with qualified majority quorums). Requirements for IFI decision-making members typically include qualification criteria as well as provisions aimed at avoiding conflicts of interest with other public or private entities. Most IFIs function as a detached body (i.e. operating on a standalone basis) while the remaining ones are either attached to or embedded[16] in other existing domestic institutions (typically national parliaments, central banks or courts of auditors). The main rationale for attachment is that it facilitates access to resources (offices, IT equipment, etc.) and enables a smooth start-up.

IFIs exhibit a large variance in allocated budgets and human resources, partly reflecting the differences in their mandate. There are a number of

[15] It is instructive to take stock of the IFIs in the candidate and potential candidate countries in the Western Balkans (Albania, Montenegro, Serbia, the Republic of North Macedonia, Bosnia and Herzegovina and Kosovo): as of mid-2019, one IFI was in place (the Serbian Fiscal Council established in 2011) and there was also a plan to found one in the Republic of North Macedonia.

[16] 'Attached' means that the IFI has financial and organisational links with the host institution (e.g. the Romanian Fiscal Council is attached to the National Academy), whereas 'embedded' signifies that the IFI is a section of the host institution (e.g. the Lithuanian Budget Policy Monitoring Department is embedded in the National Audit Office). It should be noted that some of the standalone institutions (e.g. the Bulgarian and the Hungarian Fiscal Councils) also receive administrative support from existing public bodies.

Table 11.1 Main structural characteristics of EU-11 IFIs

	Name	*Est. (1)*	*Legal base*	*Terms of office (2)*	*Set-up*	*Staff size (3)*
BG	Fiscal Council	2015	Law	6 years	Standalone**	3
CZ	Fiscal Council	2017	Law	6 years	Standalone	12
EE	Fiscal Council	2014	Constitutional Law	5 years	Attached to NCB	2
HR	Fiscal Policy Committee	2018*	Law	5 years	Standalone	Under reorganisation
HU	Fiscal Council	2011*	Constitutional Law	6 years	Standalone**	5
LT	Budget Policy Monitoring Department	2014*	Constitutional Law	n.a.	Embedded in NAO	7
LV	Fiscal Discipline Council	2013	Law	6 years	Standalone	4
RO	Fiscal Council	2010	Law	9 years	Attached to Romanian Academy	8
SI	Fiscal Council	2015	Law	5 years	Standalone	5
	Institute of Macroeconomic Analysis and Development	1991	Decree	5 years	Standalone	18
SK	Council for Budget Responsibility	2012	Constitutional Law	7 years	Standalone	15
	Macroeconomic Forecasting Committee	2012	Constitutional Law	n.a.	Standalone	Not applicable

Notes: (1) Date of establishment, year may differ from date of effective start; (*) date of reorganisation; (2) for leadership of institution (in case of different terms, for the President); (**) in administrative terms, attached to Parliament; (3) number of full-time technical staff, including administrative assistants

NAO National Audit Office, *NCB* National Central Bank

Source: European Commission's Fiscal Governance Database; IFI webpages regional bodies with solid analytical capacities with a staff of 10 or more people: the Slovenian Institute of Macroeconomic Analysis ('forecasting institutions' are traditionally the most sizeable in the EU) and the Czech and Slovak fiscal councils. This being said, most EU-11 institutions employ less than 10-strong support staff, which is consistent with the endowment of IFIs in the 'old' Member States: on average, four economists and/or statisticians are working in non-forecasting EU IFIs.[17] Funding for standalone IFIs is typically included in the central budget; other examples involve the central bank's budget (e.g. Slovak Council for Budget Responsibility) or the parliament's budget (e.g. Bulgarian Fiscal Council). In the case of attached/embedded IFIs, funding is generally provided via an earmarked appropriation within the budget of the host institution.

11.4 Zooming in on the Activities of Regional IFIs

EU-11 IFIs' mandates differ significantly in scope, and in addition, some of them perform tasks based on their own initiative, for example beyond those explicitly laid down in their statutory provisions (legislation or statutes). The remits typically consist of a subset of the following activities: (1) macroeconomic and/or budgetary forecasting (endorsement/assessment of the government's forecasts or, less frequently, autonomous production of forecasts for fiscal planning); (2) assessment of compliance with fiscal rules; (3) quantitative policy costing; (4) analysis of the long-run sustainability of public finances; (5) promotion of fiscal transparency; (6) recommendations on fiscal policy (e.g. on the fiscal stance, the composition of fiscal measures or the consequences of alternative policies). It is worth recalling that European legal requirements concern only the first two items, and naturally these are laid down as compulsory tasks for most of the IFIs. The remaining elements are typically carried out on the own initiative of the councils (legally sometimes underpinned by a broad optional reference in the mandate, such as the body 'may' prepare a report on any issues deemed to be relevant for public finances).

[17] IMF (2013: 35–36) outlines some broad principles for determining the size of the support staff: it argues that a mandate consisting of macro-fiscal assessments could properly be carried out with a staff of less than 10 analysts, the production of a fully fledged independent forecasts would necessitate a staff of at least 20, while the preparation of regular policy costings would demand the work of another 20 professionals.

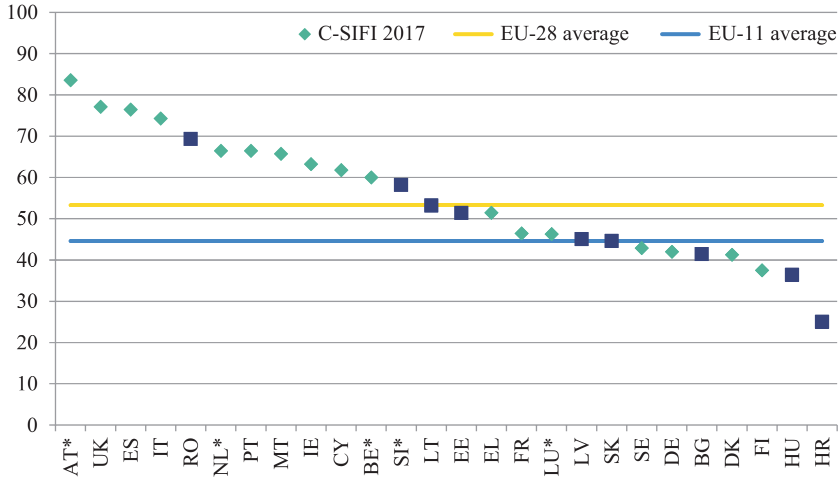

Fig. 11.3 The country-specific Scope Index of Fiscal Institutions in the EU (2017). (Note: * There are two IFIs in place in the country. Source: European Commission's Fiscal Governance Database)

Based on its Fiscal Governance Database, the Commission has recently started calculating a Scope Index of Fiscal Institutions (SIFI) that aims to measure the breadth of tasks discharged by IFIs. The index covers the above-mentioned six dimensions of IFIs' activities. The relevant scores in each category are adjusted with a 'legal force coefficient' in order to capture the elements of the official mandates. The scores are then weighted so that tasks stemming from the EU legislation carry greater importance. To better capture the breadth of IFI tasks in countries with more than one IFI (Slovenia is the only country concerned in this chapter, but in the EU, there are four more similar country cases), a country-specific index (C-SIFI) is shown in the graph in Fig. 11.3 for all MSs, which builds on the institution-level SIFI index. It appears that EU-11 IFIs generally have lower scores than their counterparts in Western European MSs, which may partly reflect that the latter are typically older institutions, out of which a higher share operate in the euro area with more encompassing EU requirements. An important caveat is that the results simply reflect the extent of the mandate, hence they should not by any means be interpreted as a proxy for the effectiveness of the respective IFIs. It is also worth highlighting that Czechia is not depicted in the graph reflecting the state-of-play in 2017 as its Fiscal Council started to operate only in 2018 (Poland is not covered either as it is the only country in the EU without a full-fledged IFI). Moreover, the score for Croatia is set to improve in the near future, as the new Fiscal Responsibility Law adopted in December 2018 reformed the Fiscal Policy Commission, also by broadening its mandate.

The remainder of this subchapter will focus on the above-listed six activities that are considered to constitute the mains tasks of the IFIs and which are executed either by all or by a subgroup of these institutions. There will naturally be a more detailed discussion on producing/endorsing/assessing official macroeconomic forecasts and monitoring compliance with fiscal rules, as these are stipulated by EU legal norms.

11.4.1 Forecasts

As mentioned above, there are more stringent requirements for euro area countries in this domain, as the Two-Pack Regulation introduced the obligation for the macroeconomic forecast underlying both annual budgets and medium-term national fiscal plans to be either produced or endorsed by independent bodies. On the other hand, it (only) obliges Member States to flag when the budgetary forecasts have been produced or endorsed by an independent institution. While appropriate arrangements are in place as regards the macroeconomic forecasts for all concerned euro area regional IFIs, none of them has so far received any formal role in the production/endorsement of the official expenditure and revenue forecasts (in the entire euro area, this was granted only to the Maltese Fiscal Council).

Out of the five euro area Member States among the EU-11, Slovenia chose to continue relying on macroeconomic forecasts produced by its independent forecaster when the Two-Pack entered into force in 2013. It seemed to be a natural choice as the Institute of Macroeconomic Analysis and Development enjoys a long-standing reputation for producing accurate forecasts. Outsourcing macroeconomic forecasts to an independent institution tends to contribute to their greater objectivity and helps to avoid problems involved in the IFI forecast endorsement process, described here below. In the remaining four regional euro area economies (Estonia, Latvia, Lithuania, Slovakia), ministries of finance have retained the task of producing the official macroeconomic forecasts which are then endorsed by independent bodies. Slovakia is a peculiar case, as the endorsement competence was conferred not to the fiscal council, but to a specialised entity, the Macroeconomic Forecasting Committee. In practice, the Ministry's forecasts are considered to be endorsed provided that a majority of the Committee members—representing independent institutions (commercial banks, the Slovak Academy of Sciences and the central bank) —deem the official forecast to be either 'conservative' or 'realistic'.

Forecast-endorsing euro area IFIs base their assessment of the government's macroeconomic forecasts on comparisons with forecasts of other institutions, without producing their own. These reference forecasts are usually those published by international institutions (European Commission, IMF, OECD) as well as national ones (central banks, think-tanks, economic research institutes, universities, commercial/investment banks). The reports accompanying endorsements typically provide a comparison to other forecasts organised by GDP components. A majority of these IFIs reports include an extensive discussion of risks involved in the government forecasts. In terms of effectiveness, the provisional calculations presented in a recent Directorate General for Economic and Financial Affairs (ECFIN) Discussion Paper (Jankovics and Sherwood 2017) appear to show some improvement in the accuracy of macroeconomic forecasting since 2014, the year in which IFIs took up the duty of official endorsers. These results, however, are based on a small sample of countries and a relatively short period of time.

Outside the euro area, regional IFIs provide at best a real-time assessment of the official forecasts. In Romania, the macroeconomic forecast underpinning budgetary planning is produced by the National Commission for Strategy and Forecasting (a body subordinated to the General Secretariat of the Government) and subsequently assessed by the Fiscal Council, without any institutional consequences in case of a critical opinion. IFIs also pronounce on the realism of official macro-fiscal forecasts in Bulgaria and Hungary. In Croatia, the Fiscal Policy Commission does not publish separate reports on the government's macroeconomic forecasts and limits itself to comparing, in the reports on compliance with fiscal rules, the government's real GDP growth forecast to the one published by the European Commission. Czechia has recently established an analogous system to the Slovak case. Specifically, in parallel to the establishment of the Fiscal Council, the Committee on Budgetary Forecasts was formed in early 2018 and tasked with assessing the plausibility of the macroeconomic and budgetary forecasts prepared by the Ministry of Finance. The (at least seven) experts are appointed for a three-year term by the government on a proposal from the Fiscal Council and work on an honorary basis.

11.4.2 Assessment of Compliance with Fiscal Rules

As documented in the literature survey above, there are clear synergies between IFIs and fiscal rules. Specifically, only well-designed fiscal rules, that is those accompanied by independent monitoring mechanisms, were found to have positive impacts on fiscal policy (e.g. improved budgetary outcomes, lowered borrowing costs). Also inspired by this empirical evidence, the notion that an independent assessor is an essential ingredient in the design of an effective numerical rule has been assimilated by many national fiscal governance frameworks.

In the EU-11, all fiscal council-type IFIs are charged with verifying compliance with general or central government rules. However, extending the monitoring to other specific sectors of the general government (such as social security) or to the subnational level is much less common. A peculiar case in point is Bulgaria, where the Fiscal Council is charged with assessing both ex ante and ex post compliance with the numerical rules laid down for the national social insurance funds. Most of the IFIs are undertaking both forward-looking and backward-looking compliance assessments.

As to the frequency of ex ante monitoring reports, a relatively popular pattern is that IFIs release two main reports annually. In such cases, typically, the spring edition analyses the country's medium-term budgetary plans (linked to the submission date of Stability/Convergence Programmes), and the autumn one deals with the planned (or adopted) budget. These reports encompass many aspects of fiscal policy, with the monitoring part usually being a dedicated subchapter of the document. These ex ante opinions are sometimes complemented by dedicated ex post compliance reports on the achievement of rules (c.f. Estonia, Slovenia or the recently started practice in Hungary). There is an evolving pattern that IFIs establish a regular schedule (either for a stand-alone publication or a dedicated subchapter in a broader document), which concludes on compliance with the domestic numerical rules for the previous year.

A genuine dialogue between the fiscal authorities and IFIs on the findings and recommendations contained in the monitoring reports benefits greatly the transparency of public finances. For the seven Member States which are bound by the Fiscal Compact in the region,[18] such a dialogue is facilitated by the so-called comply-or-explain provisions (i.e. governments 'shall be obliged to comply with, or alternatively explain publicly why they are not following the assessment of [the IFI]', under a principle which is typically enshrined in law in the concerned countries).[19] However, this requirement covers only a number of targeted cases linked to the structural budget balance rule (namely, activation of the correction mechanism, monitoring the correction process, and triggering, extending and exiting escape clauses). Moreover, as documented in Horvath (2018), in some cases the official responses to IFI opinions are neither systematic nor always pertinent to the issues raised.

The visibility of fiscal policy debates could be greatly enhanced by a publication approach which facilitates extensive coverage of government reactions by the media. For instance, the Hungarian authorities have regularly included a written response to the Fiscal Council's remarks on the preliminary draft in the explanatory annexes of the budget bill over the recent years. However, this commendable practice could not gain any meaningful traction in the media, not even in specialised outlets, as these responses were part of a bulky set of legal texts and the related budgetary documentation of sometimes more than 1000 pages.

11.4.3 Policy Costing

Policy costing consists in providing—at various stages of the budgetary cycle—estimates of the budgetary impact of new measures envisaged by fiscal authorities. Independent estimates could be essential to ensure an informed public debate and parliamentary deliberation, in particular if the government does not release its budgetary impact assessments in a consistent and timely manner. However, there are a number of important dimensions for the costing's analytical framework, which increases the resource intensity of this exercise. On the revenue side, accurate costing requires first-hand knowledge of the often-complex tax legislation and access to generally non-public databases. On the expenditure side, it often

[18] In the concerned region, the Fiscal Compact currently binds five euro area countries (Estonia, Latvia, Lithuania, Slovakia, Slovenia) and, on a voluntary basis, Bulgaria and Romania (c.f. footnote 4).

[19] See a systematic overview in the report of the European Commission (2017) assessing compliance of national legal provisions with the Fiscal Compact.

relies on detailed data which only relevant line ministries responsible for spending programmes can provide. As regards methodological options, it is increasingly acknowledged that, in many cases, it is not adequate to capture only the static impacts, but also to extend the analysis to macroeconomic feedbacks (or second-round effects). In the event of a wide-ranging tax-benefit reform package, it is justified to try to incorporate the full spectrum of dynamic effects, which would imply a further extension to behavioural changes as well. Finally, estimates should ideally be compared with a well-defined macro-fiscal baseline (i.e. technical projections prepared under the assumption of unchanged legislation or unchanged policies).

These challenges coupled with the inevitable human resource needs for undertaking rigorous computations result in that only a handful of the regional IFIs are active in this field[20] (for the entire EU, the respective share is slightly over half). In addition, none of concerned IFIs do costing over the full spectrum of new measures, but pursue a selective approach based on their own initiative. An important observation is that this group is further split between those institutions who prepare stand-alone cost estimates and others who provide only plausibility assessment of official budgetary estimates for new measures as part of their opinion on the feasibility of fiscal plans. An enlightening example for the former is the Slovak Council for Budget Responsibility, which is capable of applying both macro feedbacks and micro simulations in its quantitative work, which occasionally gets published in a separate publication ('Commentary'). Another case in point is the Romanian Fiscal Council, which works with simple analytical tools and strives to capture the static effects of measures (the related findings are used in broader fiscal assessment reports).

A costing initiative to provide clarity on the budgetary implications of party manifestos was undertaken for the first time by the Latvian Fiscal Discipline Council in the run-up to the autumn 2018 Parliamentary elections. The Council organised a survey among political parties, and as

[20] It is worth recalling that the first incarnation of the Hungarian Fiscal Council (2009–2010) was tasked with an extensive mandate in policy costing: equipped with its own staff of around 30 analysts, it was obliged to prepare budgetary impact assessments for all planned changes in the tax code and in the social benefit system (besides, it had an optional mandate for costing all other legislative initiatives). The Council's set-up was fundamentally revised in late 2010 in a controversial way, and became essentially an advisory panel with a much narrower analytical remit focusing on the annual budget bill and supported by a small secretariat.

a result published a synthetised and comparable summary about the fiscal costs of the main electoral promises. Although the Council was not in a position to certify the calculations of the political parties, it was considered a successful exercise in shifting the focus towards the appropriate financing needs for various political ideas, or more broadly towards the issues of fiscal sustainability (Kalsone and Platais 2018).

11.4.4 Analysis on Long-Term Sustainability of Public Finances

It should be recalled that there is no legal requirement in the EU acquis either for governments or for IFIs to regularly undertake long-term sustainability assessments. This being said, there are many potential uses for these analyses in fiscal policy-making: (i) underpin the design of the fiscal policy strategy (e.g. medium-term plans); (ii) influence the specification of fiscal targets both at the EU and ideally at the national level; (iii) identify policy areas (e.g. pensions, health care and long-term care) where reforms/adjustments are needed in the short to medium term.

Over the recent years, a number of regional IFIs have started to publish such assessment. Specifically, from the regional IFIs, four entities (the Czech Fiscal Council, the Latvian Fiscal Discipline Council, the Lithuanian Budget Policy Monitoring Department and the Slovak Council for Budget Responsibility) have published a dedicated report on long-term sustainability. In the case of Czechia and Slovakia, the regular production of such analysis is part of the core mandate of the respective national IFIs. The Slovak institution has an annual spring publication schedule since 2012, thus one can closely monitor the yearly evolution of long-term sustainability indicators. In the case of Lithuania, the first release (2015) of its long-term sustainability assessment, with the main conclusion that age-related spending was set to explode on a no-policy change basis, might have contributed to the drive for parametric pension reforms enacted in the subsequent year by the government.

11.4.5 Promotion of Fiscal Transparency

There are only a few EU-11 countries where there is an explicit mention about transparency as a self-standing objective or activity for IFIs. This may be explained by the fact that fostering transparency may be indirectly fulfilled by discharging other tasks (e.g. assessment of the official macro-fiscal plans and review of the government's budgetary impact studies). It is therefore rather exceptional that the Slovak Council for Budget Responsibility is explicitly tasked by the Fiscal Responsibility Act to prepare annually an evaluation report on budget transparency rules, including an assessment on the quality and availability of important information and data on public finances. Moreover, the Council recently launched "SIMTASK", a publicly available user-friendly microsimulation model of the Slovak tax and transfer system.[21] This web-based application allows for evaluating not only the static budgetary effects of parametric legislative changes in taxes and social benefits, but also the impact on disposable incomes and inequalities both at the level of individuals and households.

Furthermore, some IFIs have dedicated activities to improve the transparency of public finances, thereby contributing to a more informed debate on fiscal policy. Indeed, as users of budgetary accounts, statistics and documentation, IFIs are well placed to assess the quality and timeliness of information on budgetary matters. An example of an IFI active in the field is the Romanian Fiscal Council, with a regular chapter on fiscal transparency issues in its Annual Report.

11.4.6 Normative Recommendations

Some IFIs have the remit to top up their compliance assessments with recommendations on the fiscal stance, on the consequences of alternative policies or on more broadly defined fiscal governance issues. It is worth highlighting that issuing recommendations involves difficult trade-offs and requires a well-established reputation. From a media perspective, it raises the profile of the institution beyond a technical body, with the consequence of becoming an actor itself accountable for the relevance of its policy advice. There are a handful of regional IFIs whose legal mandate includes normative recommendations: the Czech Fiscal Council, the Croatian Fiscal Policy Commission and the Romanian Fiscal Council.

Moreover, on its own initiative the Slovenian Fiscal Council has been continuously agile in this domain as of its operationalisation in spring 2017. It has issued policy advice ranging from the stance of fiscal policy to policies to tackle demographic challenges, but also including the desirable features of the national fiscal governance legislation, in particular the provisions on the MTBF. More prominently, the Council formulated its

[21] Available at (English version): http://simtask.rozpoctovarada.sk/

policy advice to the newly formed government in autumn 2018 arguing against the full implementation of the unfunded spending promises, which would have resulted in a significant deviation from the numerical fiscal rules (the recommendations were based on an own-initiative assessment of the fiscal and macroeconomic implications of the Slovenian coalition agreement).

11.5 Conclusions

In the wake of the crisis, a number of basic requirements for the Member States' NFFs were introduced at the EU level, with a primary objective of promoting compliance with EU fiscal rules by strengthening domestic budgetary arrangements as well as by enhancing national ownership. Strong budgetary frameworks are expected to support sound fiscal policy, in particular by making use of well-designed numerical fiscal rules, promoting multiannual fiscal planning, and also through the existence of independent entities, improving the reliability of forecasting and enhancing fiscal transparency. When designing this common set of European requirements, the need for the NFFs to reflect the specificities of the Member States' legal and institutional frameworks was an important factor taken into account.

Since the adoption of the supranational NFF provisions, EU-11 domestic budgetary frameworks have registered a particularly impressive development, as illustrated by the evolution of the various indices from the Commission's Fiscal Governance Database. In turn, the progress has been even more pronounced in Central and Eastern European countries than in the 'old' Member States, since they had typically only rudimentary domestic systems before the global financial crisis, and therefore the EU requirements provided the very basis for building their national frameworks. In particular, the number and strength of domestic numerical fiscal rules have clearly been on the rise and they are now a central part of the NFFs of the 'new' Member States. The scope and transparency of medium-term fiscal planning have also been upgraded. Finally, the watchdog role of recently established IFIs has generally increased the transparency of public finances and has strengthened the public scrutiny over fiscal policy-making.

Indeed, IFIs have recently spread across the region, and by today, virtually all EU-11 Member States have at least one institution providing independent advice and input to fiscal policy-making. Given the relatively short period of time since most of the IFIs took up their duty, it is difficult to assess (both quantitatively and qualitatively) the impact of IFIs on budgetary outcomes and on the quality of fiscal policy. Nonetheless, early (primarily anecdotal) evidence suggests that these institutions do play a useful role in budgetary processes, as they exert a positive influence through the flagship six IFI functions discussed in this chapter. Several episodes were recalled in the above sections when IFIs in the region have already been successful in engaging national governments in a debate on fiscal execution and planning, thereby enhancing the public's awareness of fiscal issues. It is important to highlight that some of these activities were carried out by EU-11 IFIs without any EU legal requirements to do so and often on their own initiative, suggesting that the spread of good practices or demonstration effects across the EU have also been at play during the institution-building phase.

This being said, further efforts could be made (by legislation and/or in practice) so that IFIs in all EU-11 countries publish both forward-looking as well as backward-looking compliance assessments in a timely manner and covering most, if not all, of the domestic fiscal rules in force. In a similar vein, they could increasingly play a stronger role in the production or endorsement of official macro-fiscal forecasts, moving towards the budgetary forecasts as well. In addition, based on the existing experiences, domestic fiscal policies may benefit from a potential gradual extension of the mandate of IFIs to include those responsibilities where currently only subgroups of EU-11 IFIs are active (policy costing, long-term sustainability assessment and the promotion of fiscal transparency). Since some of these activities might require significantly more resources, such considerations should be accompanied by a reflection on appropriate resource endowment for IFIs.

References

Alesina, A., & Passalacqua, A. (2015). *The Political Economy of Government Debt* (NBER Working Paper, No. 21821).

Debrun, X., & Kinda, T. (2014). *Strengthening Post-Crisis Fiscal Credibility: Fiscal Councils on the Rise – A New Dataset* (IMF Working Paper, No. 14/58).

Debrun, X., Moulin, L., Turrini, A., Ayuso-i-Casals, J., & Kumar Manmohan, S. (2008). Tied to the Mast? National Fiscal Rules in the European Union. *Economic Policy, 23*(4), 297–362.

European Commission. (2007). "How to Stick to Medium-Term Budgetary Plans", in "Public Finances in EMU". In *Public Finances in EMU – 2007* (European Economy No. 3) (pp. 147–192). Brussels: European Commission.

European Commission. (2017). Report from the Commission Presented Under Article 8 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union – C(2017)1201, Brussels.

European Commission. (2019). *Vade Mecum on the Stability and Growth Pact* (European Economy, No. 101), European Commission, Brussels.

Fabrizio, S., & Mody, A. (2006). Can Budget Institutions Counteract Political Indiscipline? *Economic Policy, 21*(48), 689–739.

Horvath, M. (2018). EU Independent Fiscal Institutions: An Assessment of Potential Effectiveness. *Journal of Common Market Studies, 56*(3), 504–519.

IMF. (2013). *The Functions and Impact of Fiscal Councils* (IMF Policy Paper). Washington, DC: International Monetary Fund.

IMF. (2017). A Greater Role for Fiscal Policy. In *Fiscal Monitor – April*. Washington, DC: International Monetary Fund.

Jankovics, L., & Sherwood, M. (2017). *Independent Fiscal Institutions in the EU Member States: The Early Years* (European Economy Discussion Papers No. 67), Brussels: European Commission.

Kalsone, D., & Platais, J. (2018). *Report on Political Parties Survey on Fiscal Discipline Issues in 2018* (Latvian Fiscal Discipline Council, Research Papers, No. 3).

Kopits, G., & Symansky, S. (1998). *Fiscal Policy Rules* (IMF Occasional Paper, No. 162). Washington, DC: International Monetary Fund.

Nerlich, C., & Reuter, W. H. (2013). *The Design of National Fiscal Frameworks and Their Budgetary Impact* (ECB Working Paper Series, No. 1588). Frankfurt: European Central Bank.

Sherwood, M. (2015). *Medium-Term Budgetary Frameworks in the EU Member States* (European Economy, No. 21). Brussels: European Commission.

Turrini, A. (2008). *Fiscal Policy and the Cycle in the Euro Area: The Role of Government Revenue and Expenditure* (Economic Papers, No. 323). Brussels: European Commission.