EU INDEPENDENT FISCAL INSTITUTIONS

EU Fiscal and Economic Governance Review

Executive summary of the contribution from the Network of Independent EU Fiscal Institutions

This document sets out the executive summary of the wider contribution of the Network of EU Independent Fiscal Institutions to the debate on the reform of the EU Fiscal and Economic Governance.

National independent fiscal institutions (IFIs) in EU Member States are independent official bodies with mandates to monitor and assess different aspects of fiscal policy. The EU IFI Network is an independent group of 32 national IFIs that provides a platform to exchange views, expertise and pool resources in areas of common concern.

The European Commission is currently undertaking a review of the EU economic governance framework and will seek the views of the EU IFIs. National IFIs have substantial experience and expertise in monitoring fiscal policy in EU countries and in the application of the EU fiscal rules. This paper draws on those experiences as a contribution to the wider debate.

This paper was prepared by the Secretariat of the Network of EU IFIs and an ad hoc Working Group of the Network of EU IFIs; the paper is published under the responsibility of the Leadership of the Network. It does not represent the views of each institution individually.

Main messages

- There is a need to clarify the fiscal governance framework that will be applicable as of 2023, while addressing shortcomings in the existing framework.
- The current EU governance framework suffers from three main interrelated problems: weak compliance, procyclicality and excessive complexity.
- A simple and transparent multi-year approach to enforceable numerical fiscal rules should be prioritised.
- The focus should be narrowed to fewer numerical rules, while detailed implementation should be streamlined.
- The role of national IFIs in supporting sound fiscal policy should be enhanced. National IFIs are well-placed to carry out assessments of fiscal developments and sustainability at national level, taking into account domestic economic conditions.
- There should be an obligation on the EU institutions to take these assessments into account, as an input, when taking decisions on the application of the EU fiscal framework. National IFIs should retain their independence, receive timely access to information and receive an adequate level of resources in order to continue providing the objective and well-founded assessments required.
- The effective functioning of IFIs should therefore be supported by minimum national framework standards in EU Member States. This may require a broadening of national IFI mandates in some cases.
- Fiscal rules should be supported by better data and other information.

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Design of the EU fiscal framework

Clarity about the fiscal framework should be in place from 2023. To help countries address the economic damage caused by the Covid-19 pandemic, the Commission together with the Council activated the general escape clause, effectively suspending all enforcement of budgetary requirements under the SGP (EC, 2020). The clause is intended to be de-activated once the economies reach pre-crisis GDP levels, no earlier than the end of 2022 (EC, 2021). An extended period without clarity on applicable fiscal rules however might create incentives for countries to run unsound fiscal policies. It is therefore critical to clarify the fiscal governance framework that will be applicable as of 2023, while addressing shortcomings in the existing framework.

Current EU fiscal governance suffers from three main interrelated problems: (1) weak compliance; (2) procyclicality; and (3) excessive complexity. These problems are interrelated in a number of ways, including that the complexity contributes to weak compliance and ineffective enforcement and these can lead to procyclicality. The combination of these problems reduces the buy-in from Member States, key stakeholders and citizens. Addressing these issues in the future fiscal framework would help to improve EU fiscal rules and ensure sustainability of public finances after the Covid crisis.

Numerical fiscal rules

Numerical rules need to be better designed to improve compliance, reduce risks of procyclicality and be simpler. The Network does not take a position on the exact set-up of the EU fiscal rules, but assesses that a more transparent and less procyclical multi-annual fiscal framework could help to ensure that public finances are on a sustainable path.

Numerical rules can provide a transparent benchmark and objective basis for setting and assessing policy. No simple set of rules is likely to achieve optimal or even reasonable outcomes in all circumstances and across all countries over time, but good design will help. Monitoring and interpretation by national IFIs can help, both overall like providing assessments of fiscal sustainability to ensure that compliance with the rules delivers satisfactory outcomes or on specific issues in the application of the rules like the measurement of discretionary revenue measures (DRMs).

- **Complexity could be addressed by reducing the number of rules that are the focus of enforcement, or by simplifying their interpretation**.
- **Numerical rules should aim to reduce risks from high debt.** They should take into account the current macroeconomic prospects where trend growth and interest rates may remain low for a longer time.
- **Multi-year expenditure ceilings could help as an operational requirement to achieve fiscal objectives.** Any expenditure ceiling or benchmark needs to be predictable yet flexible enough to allow some adjustment if the economy follows a very different path from originally planned. Some lower bound (i.e. expenditure floor) can also be envisaged in order to smooth out expenditure and avoid sharp cuts in the times of economic downturn.
- **Investment may warrant special treatment and recognition in the design of the rules.** The advantages and drawbacks of this would need to be carefully weighed. National IFIs could provide independent assessment of the fiscal and economic impact of public investment.
- **To enhance compliance with fiscal rules, changes may be required to the design of enforcement mechanisms and surveillance.** This should be supported by improvements of the design of the rules to make them simpler and less procyclical. Surveillance of compliance with fiscal rules should also make more use of fiscal policy assessments undertaken by national IFIs.

Role of IFIs in the EU fiscal framework

The capacity of national IFIs to make independent objective assessments of national fiscal dynamics and to increase transparency could be used more effectively in the EU fiscal framework. National IFIs have expertise to make independent assessments of economic and fiscal developments based on national conditions.

There should be an obligation at the EU level to take into account national IFI assessments in several areas:

- **Measurement issues.** This could include the identification of one-offs, estimation of potential output and structural balances, and the measurement of discretionary revenue measures (DRMs). National IFIs are well-placed to understand and assess specific national circumstances, as well as implications for the overall fiscal position.
- **Discussions about methodological developments when it comes to the estimation of 'one-offs' and DRMs.** IFIs should be included in the information flow between national governments and the Commission. National IFIs should also have timely access to any methodological changes, including data and software used to derive non-observable economic cycle variables for annual assessments.
- **Compliance with rules that mirror requirements at the EU level**. National IFIs can help to promote responsible fiscal policies within the context of the SGP thanks to two main strengths: excellent knowledge of country specificities and recognised national acceptance. The role of IFIs in assessing national macroeconomic and fiscal frameworks should be given greater consideration.
- **Assessment at national level, on a regular basis, of overall fiscal sustainability and the underlying fiscal position**. This requirement should be the responsibility of a national IFI. This could take the form of a separate report that would be made public or covered as part of existing publications. National IFIs should be free to choose how they undertake this assessment.

There may be cases where Commission assessments differ to those of the national IFI, either on compliance with numerical benchmarks under the fiscal rules, the treatment of specific issues such as one-offs, or the overall fiscal position. These differences can be narrowed by providing clearer and more comprehensive common principles and guidance.

Setting minimum institutional requirements would help to ensure IFIs are strong enough at national level to fulfil their functions without compromising practices. It is critical that all EU IFIs have the mandates, institutional features and resources to function effectively and independently.

The implementation and enforcement of existing supranational independence safeguards[1] is limited in some countries. Critical capacity and access to information constraints must be addressed, in order to improve the functioning of the EU IFIs (Horvath ,2017). In line with previous statements (Network of EU IFIs 2016 and 2019), the Network proposes following list of minimum standards for IFIs:

- **A mandate to address government and parliament, and mandate to publicly disclose reports and recommendations**. To ensure sufficient transparency and maximum accountability of national governments, IFIs should be able to directly address national authorities as well as issue and disclose reports and recommendations at their discretion.

[1] Laid down in the Fiscal Compact and broadly re-confirmed in the euro area two-pack Regulation 473/2013.

- **Good and timely access to information**. IFIs should be able to obtain accurate information on demand from national statistical offices, national governments and the Commission without an undue delay and at no cost. Any restrictions on access to information should be clearly defined in law. IFIs should also be able to participate in committees at national level related to accounting or measurement aspects of fiscal policies.
- **Effective implementation of the 'Comply or Explain' principle**. This is a key instrument in the IFI toolbox to enhance national ownership under the TSCG. The details on implementation of this principle should be included and clearly defined in national regulations. Moreover, all the official correspondence between national IFIs and public administration under the "Comply or Explain" principle should be made public immediately.
- **Adequate level of resources and management flexibility**. IFI budgets should be protected from political interference, potentially through a multiyear budgetary appropriation that stretches beyond the national electoral cycle. IFIs should also have adequate flexibility to manage their resources, to ensure their independence is preserved.
- **Sufficient safeguards against political pressures**. It is essential that board members are selected under transparent procedures. The hiring process should be subject to strict rules on conflict of interest, and terms of board members should be independent of an electoral cycle. Moreover, it is paramount that IFIs are able to produce reports and analysis on their own initiative as long as the reports are consistent with the mandate of IFIs.

Including these minimum standards in the EU fiscal framework will strengthen national IFIs individually and collectively, enhancing national ownership of fiscal policies.

Statistics and information to support fiscal monitoring and assessment

The setting and enforcement of fiscal rules should be supported by better statistics and information, to support wider assessments of fiscal policy needs and sustainability based on a broad range of indicators. Existing requirements to provide reliable statistical data on the general government fiscal position in a timely and comparable way has been a key achievement of EU fiscal governance. A number of specific improvements to economic and budgetary information could be made, including:

- The requirement for Member States to produce credible medium-term fiscal projections covering at least 4 years[2], consistent with the Stability/Convergence Programme Updates.
- Changes to the fiscal rules or to their interpretation should be duly and timely communicated to the IFIs and the general public.
- Improved treatment of 'one-off' measures and DRMs in monitoring underlying fiscal positions.
- More transparency with regards to disbursement and usage of EU funds.
- Debt sustainability analyses at national level, either by governments subject to national IFI oversight or by national IFIs.
- Publication of net debt and net worth statistics.
- Publication of gross and net financing needs.

[2] Documents should cover year$_{t-1}$ - year $_{t+3}$, with fiscal projection from year$_t$ onwards.