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How to strengthen fiscal surveillance towards a medium-term focus?

Abstract

All EU member states have frameworks with a horizon for fiscal policy making beyond the annual budgetary calendar. These medium-term frameworks differ across countries both in terms of their set-up and stringency. Against this background, the main objective of this paper is to identify best practices for medium-term targets and binding nature.

This paper will assess the characteristics and pre-conditions of the effective medium-term frameworks in the EU, drawing from national experiences. This contribution is particularly relevant in the context of the Recovery and Resilience Facility since its implementation is expected to result in a significant increase in investment projects over the next three years. Moreover, special attention will be given in the contribution of the Independent Fiscal Institutions (IFIs) to fiscal discipline. Finally, the paper will come up with preliminary findings on how to strengthen the medium-term orientation of the budgetary frameworks.

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Disclaimer

Executive summary

Medium-term fiscal and budgetary frameworks are considered to play an essential role in the design and execution of fiscal policy. The growing realisation of the importance of looking at public finances from a multiannual perspective triggered a wave of reforms to national medium-term frameworks (MTFs) after the global financial crisis (GFC). This was partly promoted by both EU and intergovernmental legislation, which resulted in national frameworks across EU member states sharing some similar characteristics. Two elements stand out in the latest wave of reforms: first, fiscal rules were codified in the highest-ranking pieces of legislation across member states' legal systems – constitutional order often; and second, the structural balance became the legally predominant fiscal variable in many national frameworks.

A few years down the line, it is worth examining what happened over this last period and the extent to which these revamped national frameworks delivered on their expected benefits. Lessons from these past years can help us in the design of future fiscal and budgetary plans.

Assessing fiscal plans since 2014, member states have performed quite heterogeneously in terms of a triple benchmark: (i) delivery upon the goal of progressing towards sounder underlying fiscal positions; (ii) producing more stable fiscal plans; and (iii) increasing the predictability of fiscal policy.

This heterogeneity can be associated with three main problems in the current functioning of national MTFs, which have been identified by looking at the day-to-day experience of Independent Fiscal Institutions (IFIs) in 25 EU member states: first, there is often a considerable gap between legislation (including constitutional) and implementation; second, medium-term fiscal targets are frequently aspirational rather than constraining; and third, many IFIs find that current frameworks suffer from serious difficulties in the top-down reconciliation of fiscal and budgetary elements. In other words, medium-term *budgetary* frameworks (MTBFs) are often either lacking or detached from medium-term *fiscal* frameworks (MTFFs).

Drawing on the experience of best performing national frameworks, the effectiveness of medium-term fiscal frameworks is often found to be related to (i) strong political commitment – compatible with softer legal basis – articulated through mostly (ii) fixed fiscal targets, (iii) expressed over variables that are easily reconcilable with the budgetary-relevant aggregates, and (iv) which are operationalised through *budgetary* frameworks that clearly bring fiscal constraints into the political debate by establishing binding medium-term expenditure ceilings.

It should be stressed that strengthening medium-term fiscal and budgetary frameworks is essential in the context of the Recovery and Resilience Facility: setting out a coherent package of reforms and public investment projects over the medium term is necessary for Member States to benefit from the support of the Facility. Finally, functional MTF are key to promoting the quality of public finances: government investment and other productive spending as well as structural tax or spending reforms all require sound medium-term planning.

Introduction: medium-term fiscal vs budgetary frameworks

In the context of fiscal policy, a medium-term framework (MTF) is usually characterised as a set of interrelated systems, rules, procedures and institutions that extend the horizon of budgetary and fiscal policy beyond the annual budgetary calendar. Thus, they encompass several elements, including fiscal rules, institutions and budgetary procedures that are intimately interconnected.

Building on previous work by the EU IFIs Network (EU IFI, 2018), it is crucial for the purpose of this paper to draw a distinction between medium-term fiscal frameworks (MTFFs) and medium-term budgetary frameworks (MTBFs). MTFFs focus on multi-year macro-fiscal targets relevant at the aggregate general government level – such as the overall government balance, the structural balance or government debt – which allow governments to programme their fiscal policy for several years ahead (European Commission, 2017). In this vein, Stability and Convergence Programmes (SCPs) are an example of standardised MTFFs across EU member states, with common fiscal rules and similar reporting criteria for fiscal targets over the medium term. Parallel to the SCPs, several member states have national medium-term fiscal planning documents that follow criteria embedded in their national frameworks.

In turn, MTBFs are derived from MTFFs following a top-down approach. They focus on budgetary variables and are thus typically expressed in budgetary accounting (cash terms or other) and set limits for medium-term expenditure levels or their growth rates. They are a mechanism for prioritisation, reconciliation and presentation of multi-year expenditure envelopes. Their role consists of determining the spending agencies' resource needs and reconciling these with the overall (macro) resource envelope (EU IFI, 2018).

In this sense, MTBFs allow governments to programme their budgetary policy for longer periods of time, and are essential for bringing the fiscal constraints embedded in the MTFF into the political decision arena – since, after all, political decisions land upon budgetary elements. Absent an MTBF, fiscal targets and the political budgetary process risk becoming two different, disconnected elements. While all EU member states have a national MTFF – even though they vary in terms of political commitment, planning horizon, coverage or level of detail – MTBFs on the contrary are absent from several of them (International Monetary Fund, 2013).

According to the relevant literature, medium-term fiscal and budgetary programming is crucial for several reasons. The European Commission (2007) lists some of the benefits of using MTFs in fiscal planning, including improving the quality and stability of the decision-making process, which could result in more predictable fiscal policies. Furthermore, according to the International Monetary Fund (IMF, 2013), the use of MTFs in fiscal planning can contribute to enhancing fiscal discipline by showing the multi-year impact of planned revenue and expenditure measures, issuing early warning signals about possible sustainability issues of existing policies and setting binding multiannual expenditure ceilings. In this context, MTFs deliver better fiscal performance. Additionally, and turning more specifically to the benefits of MTBFs, the IMF (2013) points out that they improve efficiency in the allocation of budgetary resources, since public sector officials have more predictable and stable financial conditions, which helps in the planning of their expenditures. Similarly, the Organisation for Economic Co-operation and Development (OECD, 2014) points at the importance of medium-term planning for the quality of the decision-making process in different circumstances, such as in the implementation of capital projects with changing operational costs, or the adoption of programmes whose spending implications do not materialise in the year of adoption but later on.

All in all, according to the literature, effective medium-term fiscal and budgetary frameworks promote sounder fiscal positions, as well as more stable and predictable fiscal and budgetary policies.

After the global financial crisis (GFC), a large number of member states introduced medium-term fiscal provisions in their domestic legal frameworks for the first time – or considerably revamped their existing ones (Sherwood, 2015). This was partly triggered by the adoption of EU-wide legislative pieces such as the six pack (in particular Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the member states), the Treaty on Stability Coordination and Governance (and its core piece, the so-called Fiscal Compact) and the two pack. While differences across national frameworks are considerable, there are two elements that stand out in the last wave of reform. The first relates to the codification of fiscal rules in the highest-ranking pieces of legislation across member states' legal systems – constitutional order often; and the second has to do with the structural balance becoming the legally predominant fiscal variable in many national frameworks.[1]

These pieces of legislation entered into force around 2013. A few years down the line, it is interesting to examine what actually happened over that period because lessons from the past can help us in the design of the future: once again, when the current crisis is over, it will be important to design credible medium-term fiscal and budgetary plans. The experience of the last few years can provide useful lessons, by trying to identify what worked and what did not.

The 2014-2019 period is, furthermore, suitable for assessment in the sense that there was no major crisis, and imbalances in public finances needed some unwinding in several countries. Thus, it was a suitable period for the benefits of revamped national multiannual frameworks to unfold. In other words, if reinforced national MTFs had worked, fiscal policies in the EU would have been expected to be stable, predictable and resulting in progress towards the overall objective in most legislations – a balanced structural position. To test if this really happened in practice, fiscal targets from the SCPs are compared across different vintages, as well as with respect to outturn data. Furthermore, replies to a survey were collected across EU Independent Fiscal Institutions (IFIs) regarding specific national fiscal and budgetary requirements.

It is important to clarify that this paper aims to assess national frameworks. While medium-term budgetary objectives (MTOs) were already present in the EU fiscal legislation before this period, the post-GFC wave of reforms incorporated these into most national legal systems. Similarities with the EU fiscal framework are in many cases evident, since some national frameworks often mirror – at least to some extent – EU fiscal provisions. It is important to make clear, however, that this paper does not aim to assess the Stability and Growth Pact (SGP).

[1] Furthermore, requirements for the period under analysis were set at generally demanding levels – both in relation to the targeted level of the structural balance (according to the Fiscal Compact the structural balance target is set at -0.5% of potential GDP as a minimum for the majority of member states, which is sometimes more stringent than the minimum MTO as per the EU framework) and concerning the convergence path towards it (in Spain, for example, an organic law established 0.8 p.p. adjustment per year from 2014 until attainment of the 0% structural balance level).

Medium-term fiscal plans in 2014-2019: disciplined, stable and predictable fiscal policies?

Taking into account the benefits associated by the literature with medium-term fiscal planning, this section assesses member states' performance with respect to three different benchmarks. The first one assesses whether member states managed to attain structural balances closer to balance during the six-year period right after the strengthening of MTFFs.[2] The second element of assessment concerns the stability of fiscal plans. The third one assesses the predictability of fiscal policies or, in other words, whether fiscal outcomes tended to match fiscal plans.

One way to assess whether the post-GFC wave of national frameworks reforms resulted in better performance would be to compare it with performance in previous periods. However, lack of comparable data makes it difficult to perform this kind of analysis. Conversely, the comparison across member states' fiscal plans for this same period can provide interesting insights since, even though many of them share common features when it comes to their national MTFFs, there are substantial differences as well.

The different vintages of SCPs across member states provide us with comparable and useful information in this regard. While these are documents issued in the context of the EU fiscal governance framework, they also reflect and contain national specificities. Building on previous work by the EU IFI Network[3] and the European Commission,[4] the information contained in member states' SCPs is used to compare fiscal plans' performance across member states along the three elements outlined above. This analysis of the information contained in the SCPs can map member states into different categories of performance. Subsequently, the aim of this section is to try and find some useful relationship between performance and differentiated elements across member states' fiscal and budgetary frameworks. Information contained in both the Commission's MTBF Index and a specific survey circulated across national IFIs is used for this purpose.

The sample covered by this analysis includes data from the annual SCPs of EU member states, covering the period from 2011 – the first year when 2014 was planned for – to 2020. As known, these programmes contain fiscal and macroeconomic projections in a medium-term perspective for at least three years ahead.[5] The analysis below focuses on the SCPs' planning and implementation slippages since 2014 – the year when it can be considered that the bulk of the post-GFC changes introduced to MTFs was already in force.

[2] It should be noted that in the case of the many member states whose national frameworks mirror the EU one, this indicator could be affected by the elements of flexibility introduced in the EU framework to deal with unfavourable cyclical conditions or exceptional events.

[3] Report on Medium-term Budgetary Frameworks, 2018.

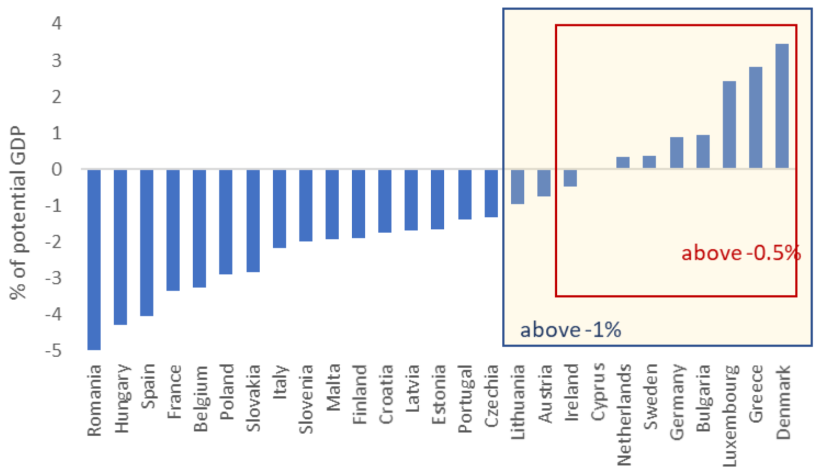
[4] Report on Public Finances in the EMU, 2014.

[5] Belgium and Poland are excluded from the analysis since their fiscal councils are not part of the Network and did not take part in the survey. Some years' SCPs are missing for some countries, as is the case for Greece and Cyprus during the programme years.

2014-2019: did fiscal policies deliver on their stated goal?

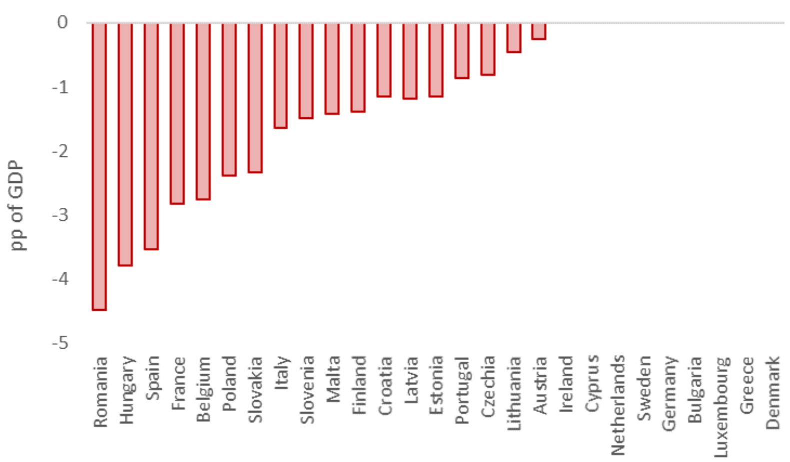
Since strengthened MTFs are expected to deliver better fiscal performance, most member states should have managed to progress towards sounder fiscal positions – as expressed by the predominant fiscal rule – over the past few years. That is, they should have reached their MTOs by 2019. Conversely, it can be observed that for most of the member states, structural deficits by the end of 2019 were larger than the -1% or -0.5% of GDP references that prevail across most national frameworks. Accumulated performance slippages – calculated as the difference between the minimum structural balance level that should have been attained in 2019 and the actual estimated level of the structural balance for that same year – are of a significant magnitude for several member states. In fact, around three quarters of member states show an overall slippage with respect to the structural balance position they should have attained had they followed the (nationally) predominant structural balance rule.

Figure 1. Structural balance, 2019



Source: Ameco 2020.

Figure 2. Overall performance slippage, 2014-2019



Note: slippage is defined as the difference between (i) the structural balance in 2019, and (ii) the one that would have been attained if each member state had implemented a 0.5 p.p. annual adjustment since 2014 until reaching the -1% or -0.5% reference as appropriate. No second-round effects are considered.
Source: Ameco 2020.

2014-2019: stable fiscal policies?

As stated in the introduction, the anchoring of expectations through stable fiscal and budgetary plans is one of the reasons why the literature argues for introducing a medium-term dimension to fiscal and budgetary planning. Stable fiscal plans are found to result in a more efficient use of resources by creating permanent conditions under which ministries and agencies can plan their expenditures. Furthermore, stable fiscal plans are a more effective way of designing and communicating fiscal policy and are usually associated with increased credibility (IMF 2013).

While achieving some degree of stability is certainly important, its relevance should be put in a wider context. In fact, there are several circumstances under which it could be argued that changing fiscal trajectories would be the optimal course of policy action. The necessary activation of an escape clause, the mere functioning of the democratic process with changes of government or the occurrence of unexpected cyclical developments are some of the factors that could call for a re-evaluation of and possible amendment to fiscal targets.

Against this background, this section assesses stability by comparing targets across different SCP vintages to determine the degree to which the planned fiscal stance – as put forward by the projected change in the structural balance[6] –changed over time. It has to be mentioned that while comparing ex-ante planned changes in the structural balance with ex-post estimated changes entails several sources of discrepancies that are outside the control of governments,[7] such sources of discrepancies are not present when plans are compared with plans. It is just a political decision – and a change in government or a change in cyclical conditions could be examples of genuinely justified reasons for that change – behind the fact that for any given year *t*, a different structural adjustment was projected in *t-3*, *t-2*, *t-1* or the same year *t*.

The average difference in the planned structural adjustment for any given year *t* is computed for two different periods. The short-term dimension is calculated as the average difference in the planned structural adjustment for year *t* as planned in *t-1* and as planned in *t*. That is, it represents the average difference in the planned structural adjustment over one year. The medium-term dimension is computed as the average difference in the planned structural adjustment for year *t* as planned in *t-3* and as planned in *t*, i.e. the average difference in the planned structural adjustment over three years.

Algebraically:

$$d(SB^t)_{iyear}^{Stab} = \frac{1}{6}\sum \left|(dSB_t^t) - \left(dSB_{t-i}^t\right)\right|$$

[6] It should be noted that there are also other approaches to estimate the planned fiscal stance – such as the narrative approach based on a bottom-up account of the estimated impact of the adopted budgetary measures.
[7] In the context of the SGP and the Excessive Deficit Procedure (EDP), these were captured by the so-called alphas and betas. See vade mecum of the SGP: https://ec.europa.eu/info/publications/vade-mecum-stability-and-growth-pact-2019-edition_en.

Where:

$t = (2014 - 2019)$

$i = (1;3)$

dSB_t^t is the change in the structural balance projected in the SCP submitted in April of year t for year t

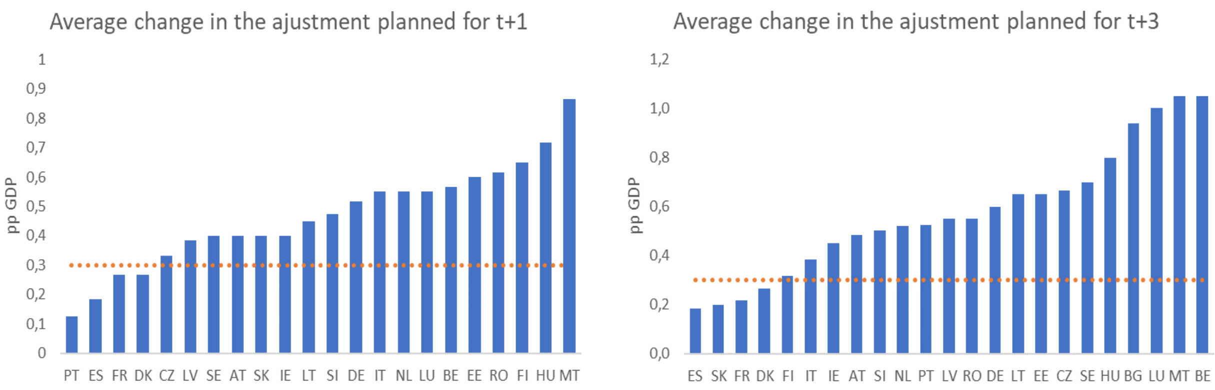
dSB_{t-i}^t is the change in the structural balance projected in the SCP submitted in April of year t-i for year t

$d(SB^t)_{iyear}^{Stab}$ is the average change on the planned fiscal stance over i years

Differently from the previous 'output' dimension – where the aim is to capture changes in a specific direction or with a specific sign, that which signals progress towards sounder underlying fiscal positions – this dimension is trying to capture stability of plans and thus computes changes in absolute value. This implicitly makes changing plans towards a more contractionary fiscal plan equivalent to changing plans towards a looser stance.

As illustrated by the graphs below, average changes to the projected fiscal stance are very substantial across member states, over both one year and three years. Drawing an (arbitrary) line at 0.3 p.p. – assuming that any average change in the planned annual structural adjustment above that level amounts to a substantial variation in the fiscal policy stance – it can be observed that most member states' fiscal planning results in changes that exceed that threshold, thus making their projected fiscal stance quite volatile. In some cases, this volatility can be related to the instability of structural balance estimations themselves.[8] In particular, in any given year a member state could find itself closer to its MTO than initially estimated, and thus change its projected fiscal plan accordingly. In any case, even if those changes were economically justified, the finding stands that projected fiscal stances changed considerably across SCP vintages.

Figure 3. Average changes to projected fiscal stance

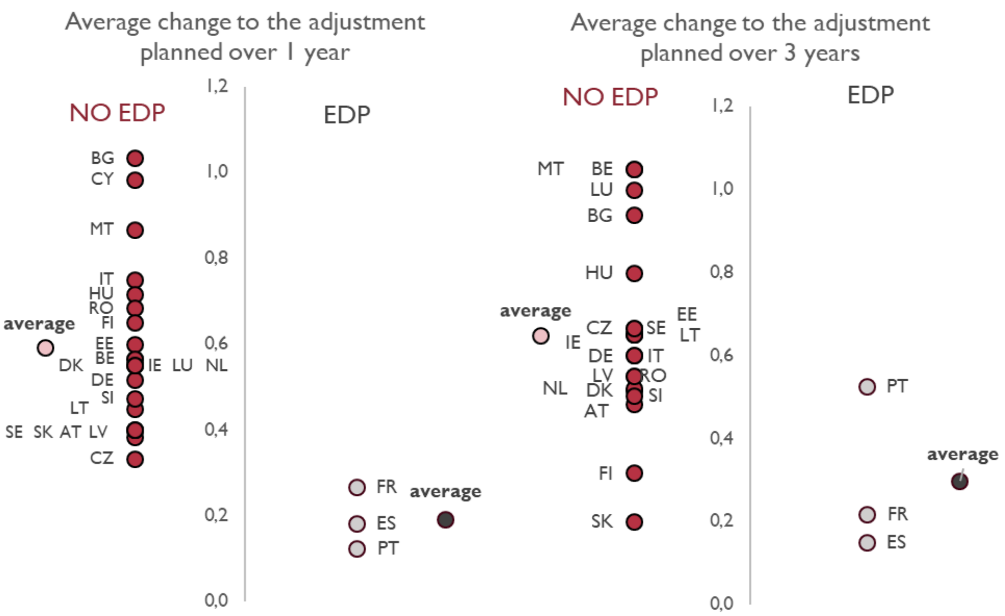


Source: SCPs and own calculations.

[8] A dedicated Output Gap Working Group has been set up within the Network of EU IFIs. This group evaluates output gap estimations following alternative methodologies and their impact on structural balance computations. For further references, see *A Practitioner's Guide to Potential Output and the Output Gap* (EU IFIs), https://voxeu.org/article/euro-area-budget-rules-spending-must-avoid-pro-cyclicality-trap and https://en.upbilancio.it/working-paper-12015/.

It is interesting to note that member states below the 0.3 p.p. line include countries that were in Excessive Deficit Procedure (EDP) for most of the period under analysis. The different timing references of the two arms of the SGP – whereby EDP recommendations contain fixed fiscal targets for several years ahead, as opposed to the preventive arm, where fiscal requirements are set on an annual basis[9] – could be a relevant element behind this development, thus suggesting that EDPs tend to override national frameworks.

Figure 4. Average changes to projected fiscal stance: EDP vs. no EDP



Source: SCPs and own calculations.

Besides assessing changes to planned structural adjustments, it is interesting to check the degree of revisions to expenditure plans as an additional relevant indicator of stability, especially in those few countries where the structural balance may not be the nationally predominant fiscal variable.

The average difference in the planned expenditure cuts or increases for any given year *t* is also computed for two different periods. The short-term dimension is calculated as the difference in the planned change to the expenditure-to-GDP ratio for year *t* as planned in *t-1* and as planned in *t*. That is, it represents the average difference in the planned change to the expenditure-to-GDP ratio over one year. The medium-term dimension is computed as the difference in the planned change to the expenditure-to-GDP ratio for year *t* as planned in *t* and as planned in *t-3*. That is, it represents the average difference in the planned change to the expenditure-to-GDP ratio over three years.[10]

Following von Hagen (2010) and the European Commission (2014), changes in expenditure-to-GDP plans can be the result of two different factors. The first one, non-discretionary, is related to changes in the GDP growth projected for year *t* across the different SCP vintages, i.e. the endogenous change in projected expenditure due to the updating of GDP growth forecasts. The second one is attributable to discretionary policy measures – with caveats linked to interest expenditure and EU funds (see below).

[9] Even though EDP recommendations were frequently changed during the past years – often reflecting different inflation or potential growth developments than those underlying the recommendations – they provided a more stable basis for medium-term EU requirements than the annual setting of requirements under the preventive arm.
[10] Assessing the variables in first differences instead of levels neutralises the most part of possible base effects and the impact of statistical revisions over the different time horizons, including the change to ESA 2010.

Similarly to von Hagen (2010), the non-discretionary component of changes to expenditure plans is proxied by multiplying the change to GDP projections by the budgetary semi-elasticity of expenditure.[11] Algebraically:

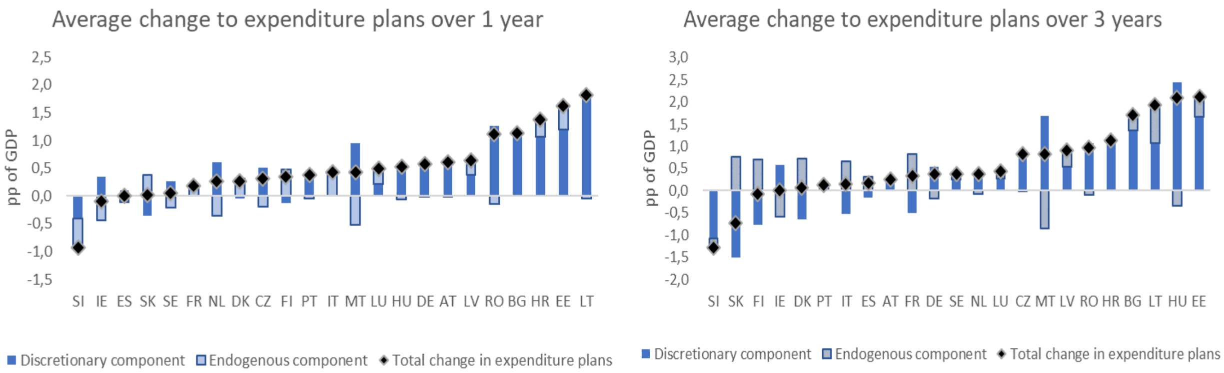
$$d(Exp^t)^{Stab}_{iyr} = \frac{1}{6}\sum((Exp^t - Exp^{t-1})_t - (Exp^t - Exp^{t-1})_{t-i}) = \varepsilon_G\left(g^t_t - g^t_{t-i}\right) + \delta^{Stab}_{iyr}$$

Where:

$$\begin{cases} t = (2014, 2019) \\ i = (1;3) \\ (Exp^t - Exp^{t-1})_{t-i} \text{ is the change in the expenditure-to-GDP ratio in year } t \text{ projected in the SCP submitted in April of year } t\text{-i} \\ \varepsilon_G \text{ is the semi-elasticity of expenditure with respect to GDP} \\ g^t_{t-i} \text{ is the GDP growth of year } t \text{ projected in the SCP submitted in April of year } t\text{-i} \\ \delta^{Stab}_{iyr} \text{ is the discretionary element of the difference in plans over i years} \end{cases}$$

Positive values of the endogenous and discretionary components correspond to most recent plans projecting looser expenditure trajectories than previous plans and vice versa.

Figure 5. Average changes to expenditure plans



Source: SCPs and own calculations.

On average, changes to expenditure plans tend to be larger over three years than over one year – as could be expected. Over both time horizons, they often result in updated plans projecting smaller reductions or larger increases to expenditure-to-GDP ratios (i.e. looser spending plans) than previous plans. When it comes to assessing the source of those changes, looser spending plans over the short term are mostly attributable to the discretionary component on average across member states. Over the medium term, roughly two thirds of the loosening in plans relates to changes in the discretionary component of the plans, while one third stems from updated growth developments turning out worse than previously expected.

[11] For comparability purposes the semi-elasticities used in the EU surveillance process are used. See https://ec.europa.eu/info/sites/info/files/economy-finance/dp098_en.pdf.

Substantial differences can be identified across individual member states. There is a first group of countries for which later plans tend to project stricter total expenditure-to-GDP developments than initial plans. Second, there are several member states that tend to keep constant their projected total change to expenditure-to-GDP ratios across plans, despite later updates projecting, on average, lower or higher GDP growth rates than initial plans (the discretionary component thus offsetting such endogenous developments). Finally, there are other member states whose later plans have tended on average to project looser expenditure-to-GDP developments than initial ones. The split of that change between the discretionary and endogenous components shows some member states keeping the discretionary part of their expenditure plans constant – thus not trying to offset the endogenous loosening of their overall expenditure plans – as opposed to other member states for which it is mainly the discretionary part of their plans that is behind looser planned expenditure developments.

The discretionary component should, however, be interpreted cautiously. First, it should be noted that throughout this period, interest expenditure projections underwent some significant revisions with respect to what was initially projected in the SCPs of several member states. Thus, this is a relevant element that could explain possible changes to expenditure plans, especially in member states where debt service expenditures are comparatively large (e.g. in Italy's 2014 Stability Programme interest expenditure in 2016 was projected at 5.1% of GDP. The 2016 update of the Stability Programme lowered it by more than 1 p.p. of GDP to 4% of GDP. Similarly, in 2014 France projected that interest spending would be at 2.7% of GDP in 2017, while three years later that projection was brought down to 1.9%). In cases where the impact of lower-than-expected interest expenditure was not offset by other higher-than-planned exogenous spending elements, this would show in the graphs above as the discretionary component of later spending plans being more restrictive than initially planned.

Similarly, changes in expenditure plans across SCP vintages might be affected by EU Structural Funds in some member states. These funds are usually not distributed evenly over the programming period. For instance, EU funds in Slovakia peaked in 2015 and dropped sharply afterwards. This resulted in the government expenditure-to-GDP ratio growing by 2.2 p.p. of GDP in 2015 and falling by 2.8 p.p. in 2016. This sharp reduction was not anticipated in pre-2016 Stability Programmes, which rather planned for expenditure-to-GDP ratios that were higher for this reason.

2014-2019: predictable fiscal policies?

Anchoring fiscal and budgetary expectations requires not only stable planning but also delivering on such fiscal plans. Furthermore, increased predictability (and stability) of fiscal and budgetary policies is a key condition for high-quality public finance measures, such as the ones that foster the green and digital transitions, as well as fiscal structural reforms concerning taxation and spending related to ageing populations to name just a few.

Thus, this third dimension of the assessment compares plans with first-release outturn data,[12] again over one year and over three years. Analogously to the assessment of stability, the overall slippage is split between an endogenous element that captures growth differences and an exogenous discretionary component. The comparison between plans and outturn data is done for both the expenditure-to-GDP ratio and the deficit-to-GDP ratio, so the evolution of revenues is also implicitly taken into consideration.

$$d(Exp^t)_{iyr}^{Pred} = \frac{1}{6}\sum((Exp^t - Exp^{t-1})_{outturn} - (Exp^t - Exp^{t-1})_{t-i}) = \varepsilon_G\left(g_{outturn}^t - g_{t-i}^t\right) + \delta exp_{iyr}^{Pred}$$

[12] As published in Ameco forecasts of year t+1 for year t for comparability purposes.

$$d(Def^t)_{iyr}^{Pred} = \frac{1}{6}\sum((Def^t - Def^{t-1})_{outturn} - (Def^t - Def^{t-1})_{t-i}) = \varepsilon_{bb}\left(g_{outturn}^t - g_{t-i}^t\right) + \delta def_{iyr}^{Pred}$$

Where:

t= (2014 - 2019)

i= (1;3)[13]

$(Def^t - Def^{t-1})_{t-i}$ is the change in the deficit-to-GDP ratio in year t projected in the SCP submitted in April of year t-i and analogously for the expenditure-to-GDP ratio.

$(Def^t - Def^{t-1})_{outturn}$ is the outturn change in the deficit-to-GDP ratio in year t and analogously for the expenditure-to-GDP ratio.

ε_{bb} is the semi-elasticity of the budget balance with respect to GDP

ε_G is the semi-elasticity of expenditure with respect to GDP

$g_{outturn}^t$ is the first-release outturn GDP growth rate

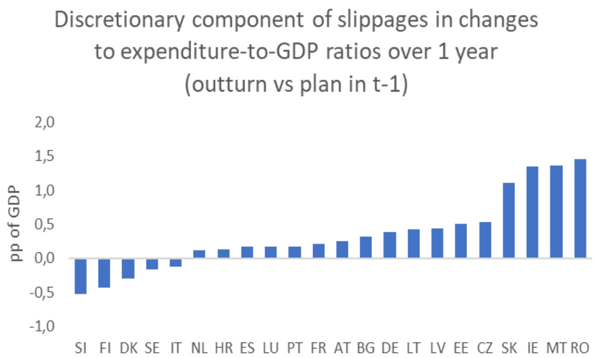
g_{t-i}^t is the GDP growth rate of year t as projected in the SCP submitted in April of year t-i

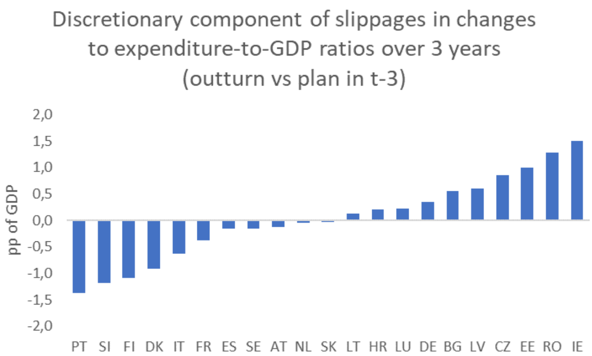
δexp_{iyr}^{Pred} is the discretionary component of the expenditure-to-GDP slippage over i years

δdef_{iyr}^{Pred} is the discretionary component of the deficit-to-GDP slippage over i years

Focusing on the discretionary element – whose negative sign in the case of expenditure implies that the discretionary component resulted in stricter outturn expenditure developments than initially planned – and performing the analysis over the short and medium-term, results show a considerable heterogeneity across member states' average predictability of fiscal plans.

Figure 6. Discretionary component of slippages in changes to expenditure-to-GDP ratios



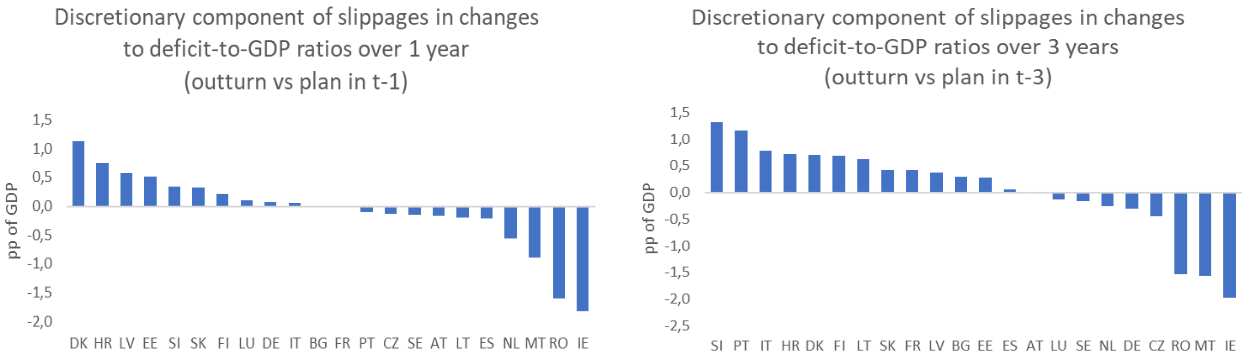


Source: SCPs and own calculations.

[13] Predictability over the short term is assessed comparing outturn data with plans submitted one year ahead (instead of the in-year plan). Slippages between plans for year *t* – as put forward in April of year *t* – with respect to outturn for *t* typically relate mostly to budgetary execution issues. In order to account also for slippages possibly stemming from fiscal planning deviations, outturn data are compared with plans one and three years ahead.

Similarly, results for the discretionary component of deficit-to-GDP slippages – whose positive signs imply a smaller outturn deficit ratio or higher surplus ratio than planned – show comparable heterogeneity.

Figure 7. Discretionary component of slippages in changes to deficit-to-GDP ratios



Source: SCPs and own calculations.

All in all – and despite seemingly comparable elements in their MTFFs – member states perform quite differently when it comes to the outcome, stability and predictability of their fiscal policies. An immediate question emerges as to whether there are national MTFF specificities that could be responsible for such differences.

The Commission's MTBF Index and performances across member states

A comprehensive attempt is made recurrently by the European Commission to systematise the different elements of MTFs by compiling qualitative indicators under five criteria: (i) coverage of the targets or ceilings included in the national medium-term fiscal plans; (ii) connectedness between the targets or ceilings included in the national medium-term fiscal plans and annual budgets; (iii) involvement of national parliaments in the preparation of the national medium-term fiscal plans; (iv) involvement of IFIs in the preparation of the national medium-term fiscal plans; and (v) level of detail included in the national medium-term fiscal plans.

These are all very relevant aspects that influence the quality of MTFs. However, although some aspects of such an index build on practical implementation issues, most of their components refer to legislated aspects that day-to-day experience shows can work differently in practice.

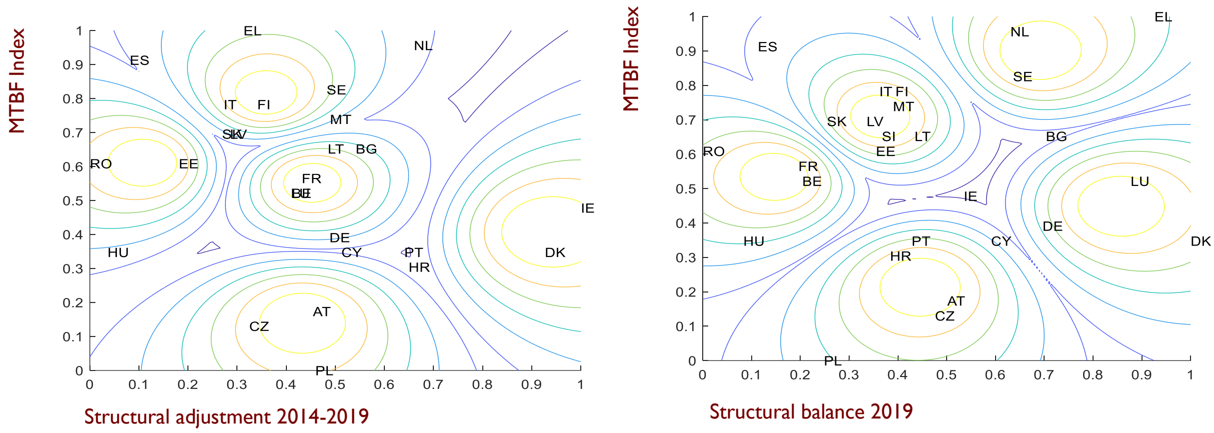
Thus, this section aims to check how the quality of MTF as captured by Commission's MTBF[14] Index relates to its performance in terms of fiscal policy's ability to deliver upon its goal, its stability and its predictability. A fuzzy clustering technique is used as a way to partition the data and detect its underlying structure (Bezdek, 1981).[15] Then the different member states are classified and grouped according to

[14] According to the distinction drawn between MTFF and MTBF in the first section of this paper, the Commission's Index would rather be an MTFF Index.
[15] For a toolbox on this technique, see "Fuzzy Clustering and Data Analysis Toolbox for Use in Matlab", Balazs Balasko, Janos Abonyi and Balazs Feil.

their similarities in terms of both the MTBF Index and their MTF performance.[16] For the purpose of this analysis, fuzzy clustering is considered more appropriate than hard clustering, as member states on the boundaries between several groups are not forced to fully belong to one of them, but rather are assigned membership degrees between 0 and 1 indicating their partial memberships. Along each dimension, better performers get normalised values closer to 1, while worse performers get values closer to 0. The centre of each cluster is the weighted mean of the data items that belong to that cluster, where the weights are the membership degrees. The distance of each member state with respect to the centre of each cluster (i.e. the concentric circle line where it lies, where each circle has a different colour representing the same ordering across clusters) represents its membership degree of each cluster.

When it comes to comparing member states' performance in the MTBF Index with the strength of their underlying fiscal positions after (at least) six years since the entry into force of revamped national frameworks, no clear positive relationship can be detected – regardless of whether the latter is measured as the end point, i.e. the structural balance level in 2019, or the adjustment performed during the period under scrutiny. Countries that undertook comparatively large efforts such as PT, DK, IE and HR are comparatively poor performers when ranked according to their MTBF Index levels. Similarly, countries with comparatively sound fiscal positions in 2019 such as DK, DE or LU fall in the bottom half of the MTBF Index ranking. When it comes to assessing the stability of fiscal plans, no clear positive relationship with the MTBF Index emerges, as also happens with the predictability of fiscal plans.

Figure 8. MTBF Index and structural balances



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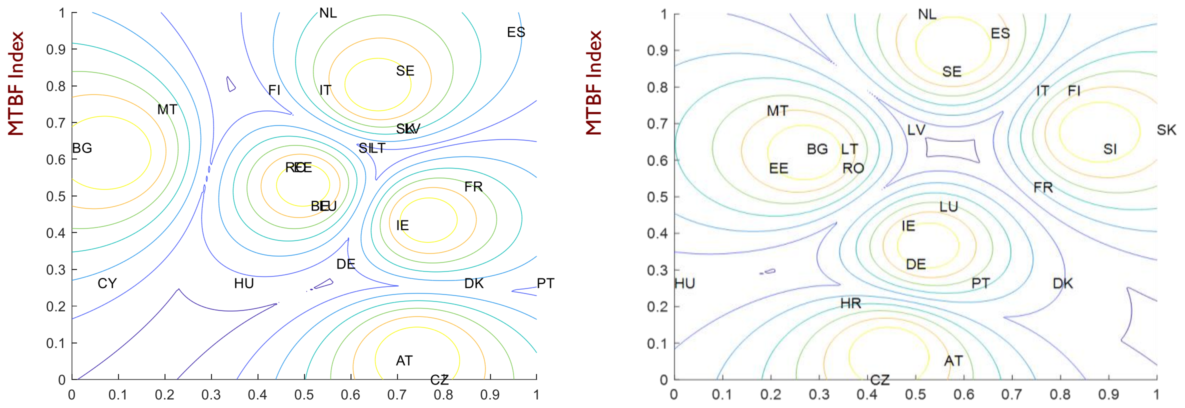
[16] Generally, the view can be accepted that a cluster is a group of objects that are more similar to one another than to members of other clusters – the term 'similarity' understood as mathematical similarity, measured in some well-defined sense. Fuzzy clustering methods (as opposed to hard clustering ones) allow objects to belong to several clusters simultaneously, with different degrees of membership. In particular, the dataset used in this analysis is partitioned into five fuzzy subsets.

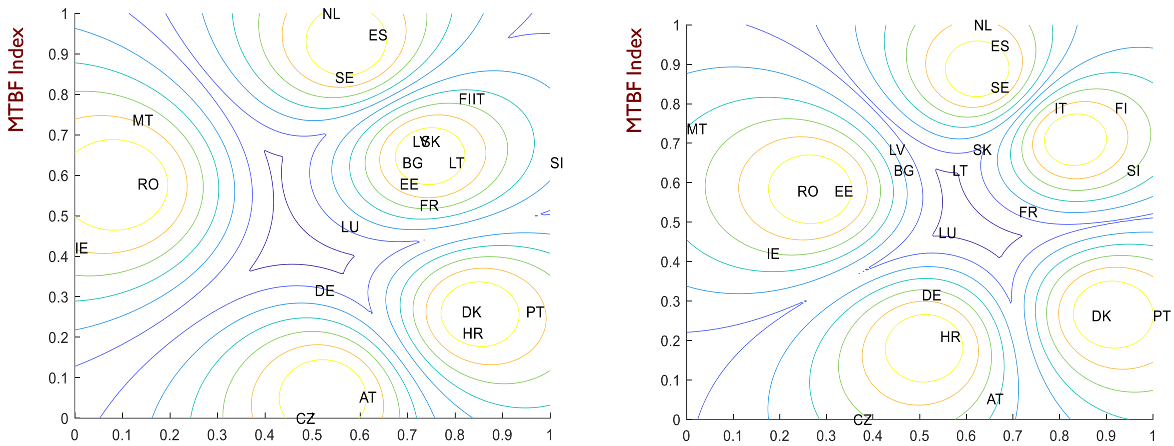
Figure 9. MTBF Index and stability of fiscal plans



Stability in structural adjustment planned over three years

Stability in discretionary expenditure plans over three years

Figure 10. MTBF Index and predictability of fiscal plans



Predictability of deficit targets over three years – discretionary element

Predictability of expenditure targets over three years – discretionary element

Sources: European Commission's MTBF Index, SCPs and own calculations.

Medium-term frameworks: legislation vs implementation

The Commission's MTBF Index accurately captures the improved legal aspects of national fiscal frameworks. However, certain aspects of national frameworks directly related to its day-to-day implementation – which are more elusive and difficult to categorise – could be left out.

With the aim of gauging some of these implementation elements across member states, a survey was conducted among the network of EU IFIs. A more detailed account of the survey's results can be found in the last section of this paper. Pooling all replies together, three main elements emerge that could complement the picture provided by the Commission's MTBF Index.

There is often a gap between legislation and implementation

The survey explicitly asked the extent to which implemented procedures or mechanisms departed from what was established in the legislation. Results confirmed that there was often a substantial gap between law and practice. In fact:

- Ten[17] out of the 26 respondents (DK, EE, EL, ES, FR, IT, LT, LV and SK) to the survey stated that there was some contradiction between legislation and implementation when it came to ex-post compensation mechanisms: in eight countries, ex-post compensation mechanisms – for different fiscal targets depending on the member state concerned – are not adhered to in practice, despite being envisaged by national legislation, while for one member state it is the other way around: the ex-post compensation mechanism is not contemplated in the national framework but works in practice.
- Seven institutions (CY, DE, DK, EL, HR, NL and SI) reported that there was a budgetary reference or benchmark that, even though not contemplated as such in the legislation, was in fact politically binding and operated as an effective constraint on fiscal and budgetary policy (e.g. the so-called black zero policy in Germany).
- Nine institutions (DE, EE, ES, FR, IE, IT, MT, PT and SI) stated that other fiscal or budgetary variables, different from the ones enshrined in the national fiscal rule, played a relevant role in the political debate.
- Concerning the role of the IFIs, three institutions (CY, EL and IE) replied that they performed an ex-ante assessment on the adequacy of medium-term fiscal targets (regarding both their compliance with fiscal rules and the appropriateness of the implied fiscal stance) even though not explicitly stated in their national legislation. In this same vein, three institutions (EE, EL, IE) replied that they provided an ex-ante assessment on the consistency between operational targets and fiscal rules, even though not explicitly contemplated in the regulation.

These examples could point to the fact that codification is probably a necessary but not sufficient condition when it comes to constraining the area of political discretion *par excellence*. In fact, experience over the past few years could be interpreted as showing that national legislative changes – such as those implemented after the GFC with (generally unattained) structural balanced targets and (generally ineffective) ex-post compensation mechanism – could turn out unsuccessful if not accompanied by aligned political relevance. The result of this is a potentially large gap between legislation and implementation that paradoxically could increase uncertainty and weaken overall institutional quality.

Medium-term targets are often aspirational rather than constraining

It is widely acknowledged that ever-changing fiscal targets do not provide an actual multiannual perspective to fiscal and budgetary planning – even when embedded in a multiannual document that: (i) covers the whole of the general government sector; (ii) is adopted by parliament; (iii) includes detailed granularity in revenue and expenditure projections; and (iv) relies on the involvement of national IFIs. This is the case for many member states, as evidenced by the survey's results.[18]

[17] Ten IFIs corresponding to nine member states because two Greek institutions took part in the survey – the Fiscal Council and the Parliamentary Budgetary Office.

[18] As stated in previous sections, stability is a desirable feature in fiscal frameworks that revolve around budgetary targets under the control of governments. It becomes apparent that the changing or rather fixed nature of the targets is very much connected to the issue of how targets are defined. Certain fiscal rules are inevitably connected

- In particular, 21 IFIs replied that their national medium-term fiscal planning document was issued on a rolling basis (AT, BG, CY, CZ, DE, EE, EL, ES, FI, HR, HU, IT, LT, LU, LV, MT, PT, RO, SE, SI and SK). This means that targets are changed annually in many cases without the need to provide any explanation. SE and FI are an exception in this regard since, even if it is legally possible to change the fiscal targets, it is politically very costly to do so. Hence, targets tend to remain fixed.
- Several IFIs stated that this yearly update of multiannual fiscal targets turned the whole national process into a purely annual one, describing the need to report on targets for the outer years as an 'academic' exercise based on pure estimates or forecasts. A number of IFIs further reported that it was actually each year's budget law that 'reset' the national MTF, rather than the opposite. Furthermore, some institutions regretted that the annual update of their frameworks implied fiscal measures for outer years that were often unspecified, with the corresponding lack of information and transparency undermining the overall credibility of budgetary forecasts and fiscal targets.
- In this same vein, many IFIs replied that targets for outer years were not realistic (BG, EE, ES, IE, IT, PT, RO, SI and SK), reported on systematic revision of targets for outer years – often of a non-negligible magnitude, in line with the instability of fiscal plans shown in the previous section – and mentioned improving the stability of medium-term targets as a key element worth improving in their national frameworks (BG, EE, ES, IE, IT, LU, MT, PT, RO and SI).
- A number of IFIs placed this aspect in connection with the underlying fiscal rules, acknowledging that both elements were closely intertwined. In particular, some stated the need to anchor medium-term net spending growth on the basis of references with low procyclicality, uncertainty or volatility (ES, IE and SI). Otherwise fiscal targets risk becoming outdated fairly soon, and then keeping them fixed turns suboptimal.[19]
- The fact that in several member states IFIs are not involved in the assessment of outer years' targets and their compliance with fiscal rules (CY, EL, ES, HU, IE, LT and PT) could be interpreted as an implicit institutional acknowledgement that those targets associated no policy guidance quality to them – otherwise IFIs may be involved in their assessment. The fact that there is no ex-post compensation of slippages with respect to fiscal or budgetary targets happening in practice is also an indication of the aspirational nature of some of the targets – which often applies also to short-term ones (CY, EE, EL, ES, FI, FR, HR, HU, IE, IT, LV, MT, PT, RO, SI and SK).

Two implications could be extracted from the above results. The first relates to the fact that many member states seem to lack a truly effective national instrument that enables them to articulate fiscal and budgetary policies in a multiannual fashion. The second relates to uncertainty, since asynchronous changes to different years included in the planning horizon often result in an incoherent view of the orientation of fiscal policy.

to targets that are constantly changing to account for unexpected events or estimation volatility. In these cases, if unchanged, fiscal targets risk becoming useless.

[19] In this same vein, institutions whose national framework targets follow the SGP requirements regretted that since preventive arm requirements were fixed only for the first year of their national MTFF, targets in the medium-term fiscal framework were inevitably frequently updated. Some IFIs stated that the development of less procyclical estimates was essential to be used as the basis for medium-term anchoring of net spending growth.

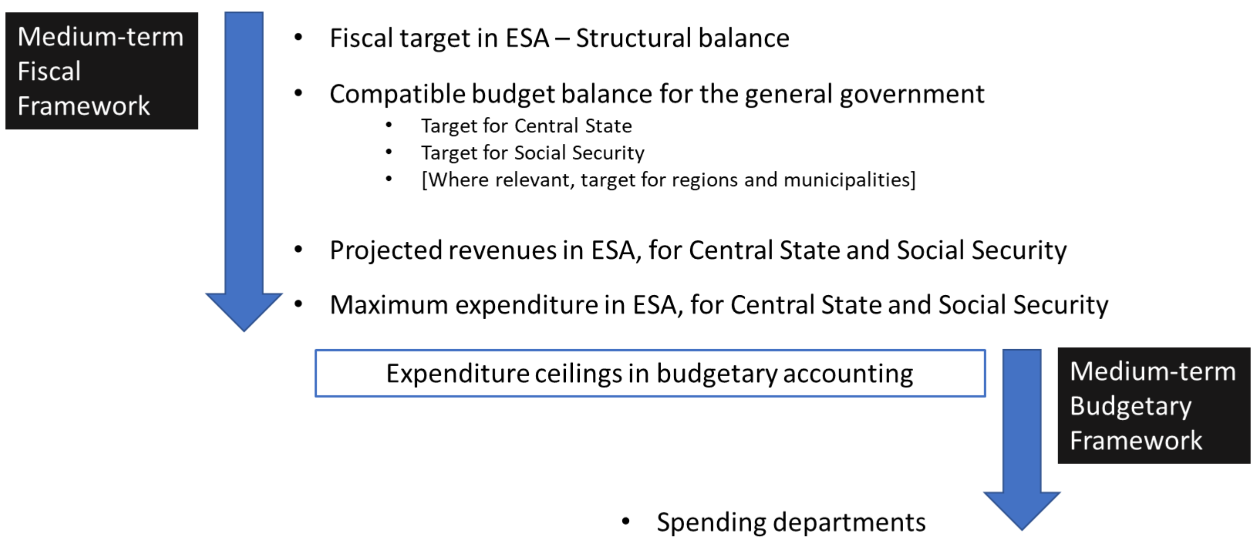
Difficulties in the top-down reconciliation between fiscal and budgetary elements

The third element that emerges from the survey's results – and is very much connected to the previous one – relates to the interlinkages between the fiscal and budgetary dimensions. A smooth top-down flow between both elements is essential to bring the fiscal constraints into the political decision process, which is channelled through a budgetary law. Otherwise they risk becoming two disconnected elements.

Generally, the process could be characterised as in the figure below, departing from medium-term fiscal requirements in national accounts terms, which currently relate predominantly to the structural balance across national frameworks. The next step involves an estimation of the output gap or the change thereof, so that structural balance targets are translated into compatible targets for the general government balance. In the case of decentralised member states, the subsequent step in the top-down process usually involves splitting the latter into targets for the different subsectors of the general government. Next, for a given path of projected revenues – given an underlying macroeconomic scenario and including possible new revenue measures – maximum compatible expenditure levels (or growth rates) are derived and expressed in national accounts terms.

Still, for these maximum levels (or growth rates) of expenditure to serve as binding references for budgetary purposes, they need to be adjusted so that they are expressed in terms of the relevant spending limits that budget laws actually refer to – that is, MTFFs have to be transformed into their compatible MTBFs, which can then constrain budget laws in the medium term. In other words, MTBFs allow the translation of structural balance requirements (or fiscal requirements more generally) into clear and consistent budgetary expenditure ceilings. In the absence of a smooth and transparent connection between these two elements, they risk being detached, with the result that the fiscal constraints are not properly brought into the political and budgetary process.

Figure 11. Connection between MTFF and MTBF in budgetary planning



Source: authors.

The survey's results show several hurdles in the current functioning of this flow related to at least three different elements:

- First, and starting at the top of the diagram above, many member states have several national fiscal rules existing at the same time, making the first steps of the process less transparent and more exposed to ad hoc management. In this sense, the majority of IFIs reported that their national frameworks embedded binding fiscal targets related to expenditure, the general government balance, the structural balance and the government debt. Several of them reported that national systems were thus too complicated and in need of simplification.

- Second, the larger the conceptual and statistical difference between the fiscal targets at the top of the diagram and the variables that are actually involved in budget preparation (i.e. the greater the number of steps involved between the top of the diagram and its middle) the less transparent and the more unstable the system becomes.

  It is interesting to note that the Greek and Cypriot IFIs reported on their fiscal targets being changed from the structural balance to the (programme definition of the) primary balance during the years of the macroeconomic adjustment programme. While theoretically the structural balance captures precisely the budgetary and fiscal elements under the control of governments, in fact, the former specific country examples could be showing that it is easier to navigate around this top-down flow when fiscal targets are more directly connected to the relevant budgetary elements, i.e. when the variables that fiscal rules are trying to constrain are more easily reconcilable and relatable to the budget. Similarly, fiscal policy in the Netherlands was geared towards a primary balance target in the earlier 1980s.

- The third element – lying at the middle of the diagram – relates to the absence of a functional MTBF in many member states. Often there is just an annual budgetary 'declination' of the relevant annual fiscal target instead of medium-term binding budgetary ceilings. MTBFs should serve as an operational bridge between the fiscal and the budgetary dimensions of the process, and would typically include a (cash) expenditure ceiling of some kind.

  In fact, when asked which elements of their current frameworks could be improved, several IFIs mentioned aspects related to the absence of an MTBF, or its poor connection with the MTFF (ES, IT, PT, RO and SK). More specifically, elements in need of improvement in their current frameworks as mentioned by the EU IFIs included: "*reconciliation between 'operational budgets' and the targets defined using national accounting standards"* (Italian IFI); "[The current framework] *does not demonstrate the compatibility of the objective of the budget balance in national accounts with the expenditure limits [in public accounts/cash basis] established in the Multiannual Public Expenditure Framework"* (Portuguese IFI); "*To include firmly the obligation that the annual budget should conform with the fiscal rules"* (Romanian IFI); and "*More transparent and clear connection between the required adjustment in the MTFF, the operational targets and the budget"* (Spanish IFI).

What do best performers' frameworks have in common?

Having examined some implications of the aggregated results to the survey, this section explores in more detail the national frameworks of those countries that have performed better in the past few years in terms of the triple dimension under examination: progress towards sounder fiscal positions, stability of fiscal plans and predictability of fiscal plans.

Denmark is a very relevant case in point since, despite ranking comparatively low in terms of the MTBF Index, shows good performance records in terms of both the stability and predictability of its fiscal plans, as well as soundness of its underlying fiscal position over the past few years. Against the background of the previous section, two features stand out when characterising its national MTF.

First, medium-term targets are binding rather than aspirational, as illustrated by the fact that: (i) its national planning instrument covers a fixed period of time, so targets are not updated annually; and (ii) ex-post compensation for slippages does take place in practice. Second, Denmark has in place a functional MTBF, as fiscal targets are translated into compatible medium-term expenditure ceilings in cash or budgetary terms that are both adopted and adhered to.

Other member states whose national frameworks can be considered to have both constraining – rather than aspirational – medium-term fiscal targets and an effective MTBF in place are the Netherlands, Finland, Sweden and Austria. The Netherlands is a well-known example of a national framework articulated around multiannual expenditure ceilings set in cash terms (MTBF), with a strong political commitment to adhere to them as part of the coalition agreement (fixed constraining targets).[20]

Finland and Sweden both have relatively fixed fiscal targets over the medium-term, even though they are contained in a document issued on a rolling basis and could in theory, therefore, be changed. In both member states, however, there is a strong expectation that the government will keep to the plan – which is adopted at the beginning of each political term – and deviating from it without a justified reason would be politically costly. In these cases, as well as in the Netherlands, IFIs remarked that political restrictions and constraints were stricter than legal ones. Furthermore, in both Finland and Sweden the medium-term fixed fiscal targets have their corresponding expenditure ceilings expressed in budgetary accounting.

In turn, Austria's framework – though revolving around medium-term documents that are issued on a rolling basis – has some binding quality to its medium-term fiscal targets in the sense that it includes an ex-post compensation mechanism for the structural budget target that – differently to the majority of member states – operates in practice. In fact, deviations from the target are to be registered on a 'control account', which must be settled after exceeding a certain threshold.[21] Adjustments to the structural balance resulting from the settlement of the control account are incorporated into the annual expenditure ceilings. Furthermore, medium-term budgetary planning is well established in the Austrian framework, where the political discussion revolves around the federal expenditure ceilings in cash terms for the next four years.

Portugal is worth mentioning too, since it is among the member states that have shown more progress towards their structural balance objectives as well as having relatively stable and predictable spending policies over the medium-term. Portugal has some sort of MTBF in place by which multiannual total expenditure ceilings, compatible with the fiscal rules, are set on a cash basis. However, the binding nature of the cash expenditure ceilings beyond *t+1* is soft. Nevertheless, since Portugal was in EDP for most of the period under analysis, it could be argued that targets beyond *t+1* were attributed a more constraining nature during those years. Thus, the combination of relatively fixed, binding EDP targets and the operation of the Portuguese MTBF provided the overall national framework with the elements necessary to put forward a stable, predictable and disciplined fiscal policy over these past years.

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[20] See https://www.euifis.eu/images/MTBF_PAPER.pdf for further detailed explanations on the Dutch and French systems.

[21] In detail, the control account needs to be settled when its cumulated balance is lower than -1.25% of GDP, while taking into account the evolution of the business cycle (i.e. given a positive change in the output gap).

The graphs below point towards these two elements (well-functioning national MTBFs and fixed fiscal targets) having some ability to discriminate across member states' performance along the dimensions of stability and predictability of fiscal plans.[22] Results are presented in terms of the discretionary component of expenditure plans over three years, but are similar when considering the one-year dimension and also when the stability of plans is assessed with respect to the structural adjustment target. Some smaller differences can also be observed in the soundness of the underlying fiscal position as expressed in terms of the structural balance level registered by the end of 2019.

[22] For the purpose of this analysis, member states that were in EDP for most of the period are classified as having fixed targets.

Figure 12. Stability of the discretionary component of expenditure plans over three years

Normalised values: 1=best performers; 0=worst performers[23]

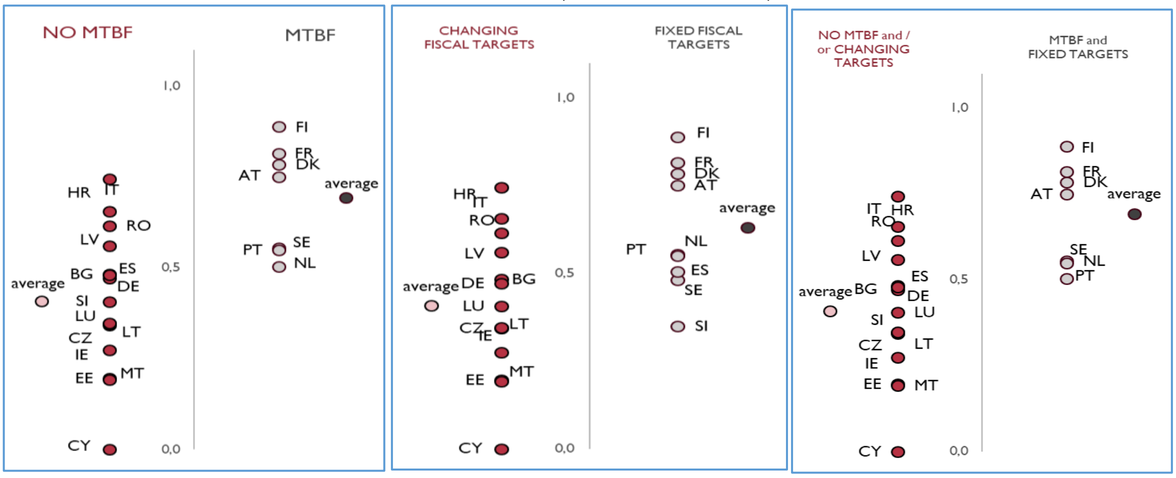


Figure 13. Predictability of the discretionary component of expenditure plans over three years

Normalised values: 1=best performers; 0=worst performers

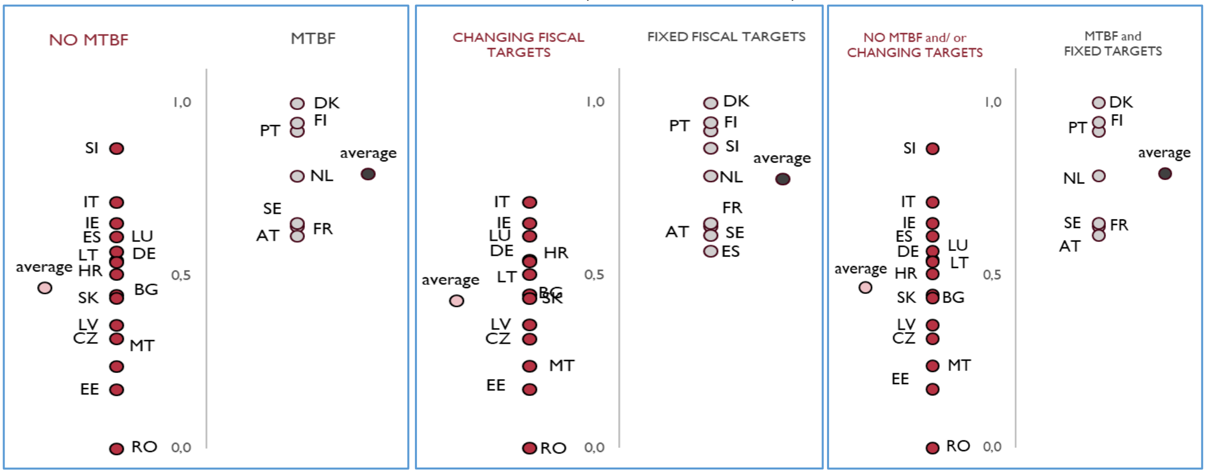
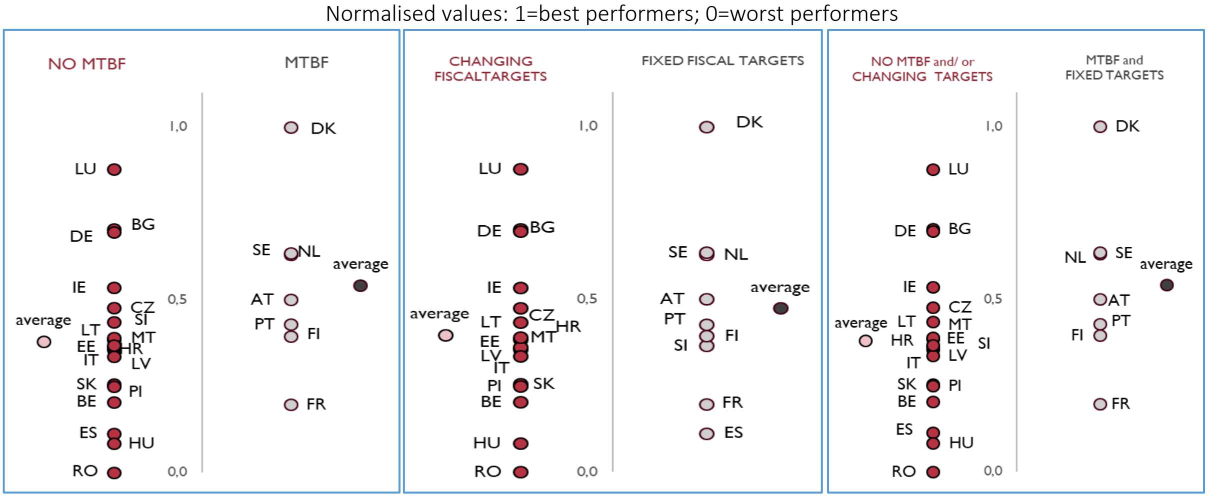


Figure 14. Structural balance level, 2019

Normalised values: 1=best performers; 0=worst performers



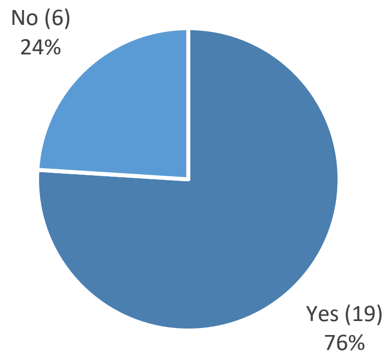
Sources: SCPs, Ameco, EU IFIs survey and own calculations.

[23] Results for SK are not shown in this graph because they are very much dependent on the 2016 observation, linked to the drawdown of EU structural funds, which distorted the results and the graph (see above).

National experiences with medium-term fiscal and budgetary frameworks

There are various MTFFs and MTBFs in place across EU member states. The IFI survey results covering 25 EU countries[24] show that these frameworks differ substantially in terms of the periodicity of their plans, the statistical terms in which they are expressed, the binding nature of the targets and how they are operationalised. Most of these differences are reflected in the medium-term fiscal planning document underpinning the national framework. This document is essentially a medium-term plan issued by the national government laying down a path for public finances. The large majority of the EU countries (19[25] of 25) have two medium-term fiscal planning documents: a national one and the SCP (see figure below). In the remaining six countries[26] there is just the SCP.

Figure 15. Country-specific medium-term fiscal planning document besides SCP



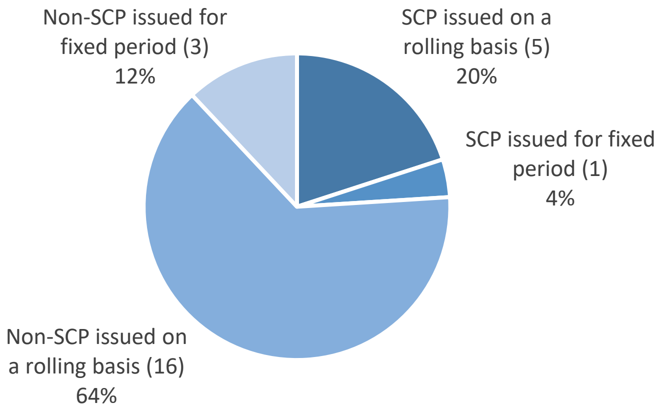
Note: IFIs were asked "Is there a country-specific medium-term fiscal planning document besides the Stability and Convergence Programme?". Figures in brackets indicate the number of countries.
Source: Network of EU IFIs (2020).

A notable difference is the rolling or static nature of the national medium-term fiscal document. In the majority of countries (21 of 25)[27] it has a 'rolling' character, i.e. medium-term perspectives are revised every year. There are only four countries[28] that formally set their targets for a fixed period, which are usually not revised until the end of that period.

MTFFs set on a fixed basis are usually linked to political cycles, where they are drafted and published at the start of each new electoral term. Only in three countries[29] do national country-specific medium-term documents that are issued on a rolling basis also follow the electoral term. In Romania, the fiscal strategy follows the ruling party's economic programme, but its ceilings are revised after each annual budgetary cycle. In turn, in Finland and Sweden, although the fiscal plans are issued every year, the targets tend to remain the same for the entire duration of the political mandate.

[24] AT, BU, CY, CZ, DE, DK, EE, ES, FI, FR, GR, HR, HU, IE, IT, LT, LU, LV, MT, NL, PT, RO, SE, SI, SK.
[25] AT, BU, CY, CZ, DE, DK, ES, FI, FR, GR, HR, LT, LU, LV, NL, PT, RO, SE, SI.
[26] EE, HU, IE, IT, MT, SK.
[27] AT, BU, CY, CZ, DE, EE, ES, FI, GR, HR, HU, IT, LT, LU, LV, MT, PT, RO, SE, SI, SK.
[28] DK, FR, IE and NL. Ireland is the only exception – usually SCPs are issued on a rolling basis, but Ireland's Stability Programme covers three to five years.
[29] FI, RO, SE.

Figure 16. Medium-term fiscal planning document publication format

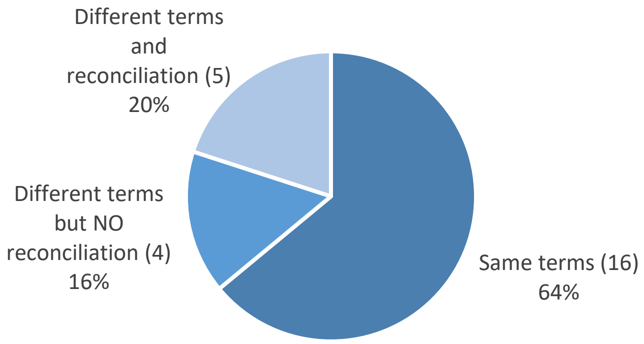


Note: IFIs were asked "How is the medium-term fiscal document issued?". Figures in brackets indicate the number of countries.
Source: Network of EU IFIs (2020).

Another difference across member states concerns the terms in which medium-term fiscal targets are expressed. Fiscal rules in most countries set ceilings in accrual terms (national accounts), while draft budgets are frequently defined in cash terms. In cases where medium-term fiscal documents and draft budgets are prepared in different terms, the two need to be reconciled in order to become comparable and assess the extent to which the draft budget is compliant.

In most countries (16 of 25)[30] the medium-term fiscal document and draft budgets are prepared in the same terms, hence no reconciliation is needed. In the remaining countries, they differ. While in four countries[31] the reconciliation is prepared and published by the government, in five countries[32] the reconciliation is either not transparent or not published at all. This substantially complicates assessments by national IFIs, as they have to perform the reconciliation themselves.

Figure 17. Terms in which medium-term fiscal document and draft budget are prepared



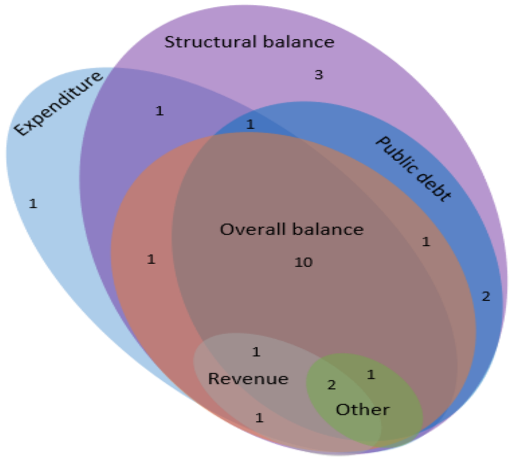
Note: IFIs were asked "If the medium-term fiscal document and draft budget are prepared in different terms, is there any reconciliation between the two?". Figures in brackets indicate the number of countries.
Source: Network of EU IFIs (2020).

In most countries, binding targets specified by the national fiscal framework reflect the four main EU fiscal rules (i.e. deficit rule, debt rule, structural balance rule and expenditure benchmark). The

[30] AT, BU, CZ, DK, EE, FR, GR, HR, HU, LT, LU, MT, NL, RO, SE, SK.
[31] IE, IT, LV, SI.
[32] CY, DE, ES, FI, PT.

structural balance is the most common binding fiscal target in the EU, since it is present in nearly all countries (24[33] of 25). In most countries fiscal frameworks also set a binding target for government debt, general government deficit and expenditure. Additionally, in four countries[34] fiscal frameworks have a binding target for government revenues. Only in the Netherlands does the government not need to compensate for revenue shortages if the target is not achieved, as this is regarded as part of letting automatic stabilisers work. Additionally, three countries[35] have other medium-term binding fiscal or budgetary targets, notably a ceiling on the cash balance of the state budget (Italy), a binding ceiling on national medium/long-term sustainability balance (the Netherlands) and a primary balance (Romania).

Figure 18. Fiscal indicators for which MTFF sets a binding target

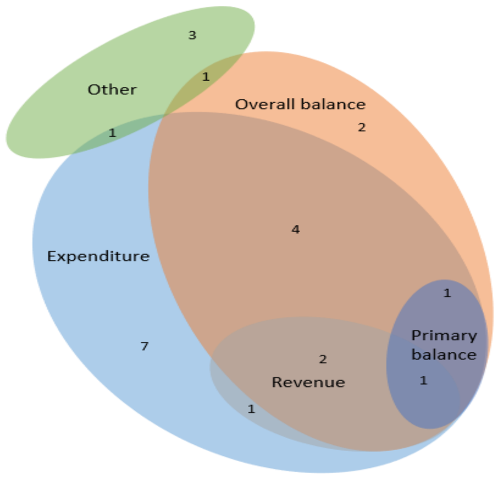


Note: IFIs were asked "For which variables does the MTFF set binding targets?". Figures in brackets indicate the number of countries.
Source: Network of EU IFIs (2020).

Binding fiscal targets are usually transposed into the draft budget through one or two intermediate targets (hereinafter 'operational targets') which are easier to reconcile to budget lines. Most often, the structural budget requirement and other binding fiscal rules translate into budgetary references through ceilings on government expenditure and/or its overall balance. Indeed, two-thirds of the countries (17[36] of 25) specify expenditure ceilings and almost half of the countries (11[37] of 25) the government balance.[38] Five countries[39] have other operational targets, including the impact for local government finances stemming from discretionary central government measures (Finland), primary surplus (Greece), debt rule (Hungary), net balance to be financed of the state budget and gross financing needs (both Italy) and state budget (Slovakia).

[33] AT, BU, CY, DE, DK, EE, ES, FI, FR, GR, HR, HU, IE, IT, LT, LU, LV, MT, NL, PT, RO, SE, SI, SK.
[34] GR, LV, NL, RO.
[35] IT, NL, RO.
[36] AT, BU, CZ, DE, DK, ES, FI, FR, HR, IE, LT, LV, NL, PT, RO, SE, SI.
[37] DE, EE, ES, HR, HU, LV, MT, PT, RO, SE, SI.
[38] Operational targets are not mutually exclusive.
[39] FI, GR, HU, IT, SK.

Figure 19. Fiscal indicators around which the draft budget is prepared



Note: IFIs were asked "Around which binding targets is the draft budget prepared?". Figures in brackets indicate the number of countries.
Source: Network of EU IFIs (2020).

Several countries[40] also have budgetary references and benchmarks that are not legally but politically binding. For instance, in Croatia deficit determined by the budget for the next budget year is constrained by the official deficit projections. In Cyprus, the government attempts to uphold a stricter MTO – 0% instead of -0.5% of GDP – as allowed by the legislation. The same rule exists in Denmark and Slovenia. In Germany, the federal government follows a so-called black-zero rule, by which the government budget must be balanced without issuing new public debt. In Greece the first two years in the planning are considered as fixed in the sense that changes can only be made in exceptional circumstances outside the direct control of the government.

IFIs play a key role in the ex-ante assessment of medium-term fiscal targets. Depending on the mandate, IFIs assess the adequacy of medium-term fiscal targets in terms of their compliance with rules and appropriateness of fiscal stance. Additionally, IFIs estimate consistency between operational targets and fiscal rules.

Most IFIs (21 out of 26 respondents) have a mandate to assess compliance of the medium-term targets with fiscal rules. Most of them (19) assess the targets for the whole planning horizon, whilst two IFIs have a mandate to assess targets only for the next year. Additionally, three IFIs do not have a mandate but carry out the assessment nevertheless. Most IFIs that evaluate the compliance of medium-term targets also assess how consistent operational targets are with fiscal rules (see figure below).

Fewer IFIs (4) have a mandate to assess the appropriateness of the fiscal stance. Three IFIs have a mandate to evaluate fiscal stance for the whole planning horizon, and only one IFI evaluates fiscal stance for the next year. However, 11 IFIs evaluate the fiscal stance of their respective governments for internal purposes.

[40] CY, DE, DK, GR, HR, SI.

Figure 20. IFI mandates in terms of medium-term targets assessment

Independent Fiscal Institution	Mandate for ex-ante compliance assessment of medium-term fiscal targets with fiscal rules	Mandate for ex-ante assessment of consistency between fiscal and budgetary elements	Mandate for ex-ante compliance assessment of medium-term fiscal targets with appropriate fiscal stance
AT FISK	Yes, for the whole planning horizon	No	No, but in practice it does
BU BFC	Yes, for the whole planning horizon	Yes, for the whole planning horizon	Yes, for the whole planning horizon
CY CFC	No, but in practice it does	No	No, but in practice it does
CZ NFC	Yes, for the whole planning horizon	Yes, for the whole planning horizon	No, but in practice it does
DE ABSC	Yes, for the whole planning horizon	No	No
DK ECD	Yes, for the whole planning horizon	Yes, for the whole planning horizon	N/A
EE EFC	Yes, for the whole planning horizon	No, but in practice it does	No
ES AIReF	No	No	No
FI EPC	No	No	No
FI NAO	Yes, for the whole planning horizon	Yes, for the whole planning horizon	Yes, for the whole planning horizon
FR HCPF	Yes, for the whole planning horizon	N/A	No
GR HFC	No, but in practice it does	No, but in practice it does	No
GR PBO	Yes, for the whole planning horizon	Yes, for the whole planning horizon	N/A
HR FPC	Yes, for the whole planning horizon	Yes, for the whole planning horizon	No, but in practice it does
HU HFC	Yes, for next year	Yes, for next year	Yes, for next year
IE IFC	No, but in practice it does	No, but in practice it does	No, but in practice it does
IT PBO	Yes, for the whole planning horizon	No, but in practice it does	No, but in practice it does
LT NAO	Yes, for next year	Yes, for next year	No, but in practice it does
LU NCPF	Yes, for the whole planning horizon	N/A	N/A
LV FDC	Yes, for the whole planning horizon	Yes, for next year	Yes, for the whole planning horizon
MT FAC	Yes, for the whole planning horizon	Yes, for the whole planning horizon	No
NL CPB	No	No, but in practice it does	No
NL RvS	Yes, for the whole planning horizon	Yes, for the whole planning horizon	No, but in practice it does
PT PFC	No	No	No
RO RFC	Yes, for the whole planning horizon	Yes, for the whole planning horizon	No, but in practice it does
SE FPC	Yes, for the whole planning horizon	No	N/A
SI IMAD	No	No	No

Independent Fiscal Institution	Mandate for ex-ante compliance assessment of medium-term fiscal targets with fiscal rules	Mandate for ex-ante assessment of consistency between fiscal and budgetary elements	Mandate for ex-ante compliance assessment of medium-term fiscal targets with appropriate fiscal stance
SI SFC	Yes, for the whole planning horizon	Yes, for the whole planning horizon	No, but in practice it does
SK CBR	Yes, for the whole planning horizon	Yes, for the whole planning horizon	No, but in practice it does

Source: Network of EU IFIs (2020).

Conclusions and preliminary findings

While improving the legislated aspects of MTFs was a necessary step after the GFC, experience over the past years has shown that it was not enough. Day-to-day hands-on practice by EU IFIs shows that there are often substantial gaps between what is embedded in legislation and how fiscal and budgetary processes operate in practice. Furthermore, in several member states MTFs have turned into a purely formal exercise: it boils down to the yearly filling out of multiannual templates with no further quality to them than mere technical assumptions or aspirational fiscal developments.

Once GDP growth gains momentum and the economic recovery is fully on track, EU member states will likely need to embark on another episode of fiscal adjustments. The political EU-wide consensus at the previous round could be characterised as one aiming to increase credibility through intense codification (both in terms of number of provisions and their legislative rank) and adjustment ambition. Initial EDP recommendations and their required efforts attest to that. This time round, it might prove more effective if consolidation plans are based on targets that – while ensuring enough progress towards sounder fiscal positions – are realistic, stable, easily reconcilable with budgetary aggregates and successfully delivered – rather than more 'abstract' fiscal plans that end up being constantly changed or simply missed. Moving forward, adjustment paths need to be designed that cater for all three references of medium-term fiscal plans: performance, stability and predictability.

The experience of past years also shows that it was difficult for (the many) member states with national frameworks that mirror EU requirements to plan for the medium term, if such requirements are only known for *t+1*. At the same time, if fixed targets are formulated with respect to fiscal aggregates whose estimates vary widely across forecast vintages – e.g. the structural balance – this may easily turn suboptimal as those fixed targets can become outdated with the change in estimation. Consequently, fiscal policy guidance is no longer useful. In other words, it will be difficult to have functional MTFs in the future without changing the underlying fiscal rules and the way in which targets are formulated. In any case, the aim of this paper is to draw attention to the potential to strengthen MTBFs in addition to MTFFs.

All in all, results stemming from an examination of past fiscal policy plans and specific elements of national frameworks seem to point to the relevance of four elements for MTFs to function effectively: (i) strong political commitment – compatible in some countries with softer legal basis; (ii) that MTFs are articulated through constraining fiscal targets; (iii) that they are expressed over variables that are easily reconcilable with the fiscal and budgetary elements of the process; and (iv) that they are embedded in an MTBF. In fact, the national frameworks of the best performing member states point to the importance of having functional MTBFs in place that effectively translate aggregate fiscal requirements into clear and consistent budgetary expenditure ceilings. Smooth complementarity between MTFFs and MTBFs is essential to bring the requirements of fiscal rules into the political debate – which ultimately always lands upon budgetary variables. It is also essential in the context of the Recovery and Resilience Plans since Member States are required to set out a consistent medium-term programme including public investment projects.

Future lines of work could include an in-depth assessment of ex-post compensation mechanisms across member states, and the interlinkages between national frameworks and the fiscal rules in the SGP.

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Annex: list of members of the Network of EU IFIs

Acronym	Fiscal Council
AT FISK	Austrian Fiscal Advisory Council (FISK)
BG BFC	Bulgarian Fiscal Council
CY CFC	Cyprus Fiscal Council
CZ CNFC	Czech Fiscal Council
DE IABSC	German Advisory Board to the Stability Council
DK DEC	Danish Economic Council
EE EFC	Estonian Fiscal Council
ES AIReF	Spanish Independent Authority for Fiscal Responsibility
FI EPC	Finnish Economic Policy Council
FI NAO	Finnish National Audit Office
FR HCPF	French High Council of Public Finances
GR HFC	Hellenic Fiscal Council
GR PBO	Hellenic Parliamentary Budget Office
HR FPC	Fiscal Policy Commission
HU HFC	Hungarian Fiscal Council
IE IFC	Irish Fiscal Advisory Council
IT UPB	Italian Parliamentary Budget Office
LT NAO	Lithuanian National Audit Office
LU NCPF	Luxembourg National Council of Public Finance
LV FDC	Latvian Fiscal Discipline Council
MT MFAC	Malta Fiscal Advisory Council
NL CPB	Netherlands Bureau for Economic Policy Analysis
NL RVS	Netherlands Council of State
PT PFC	Portuguese Public Finance Council
RO RFC	Romanian Fiscal Council
SE FPC	Swedish Fiscal Policy Council
SI IMAD	Slovenian Institute of Macroeconomic Analysis and Development
SI SFC	Slovenian Fiscal Council
SK CBR	Slovak Council for Budget Responsibility
UK OBR	British Office for Budget Responsibility

The Network of EU Independent Fiscal Institutions

The Network is composed of 30 Independent Fiscal Institutions representing 25 EU countries and the UK. It is a voluntary and inclusive institution, open to all independent fiscal oversight bodies operating in the EU. It provides a platform to exchange views, expertise and pool resources in areas of common concern. The Network supports the efforts to review and reinforce the EU fiscal framework, seeking to better exploit the synergies between rules and institutions, as well as between different levels of administration whilst respecting the principle of subsidiarity and enhancing local ownership and accountability.

For further information, visit the website: www.euifis.eu