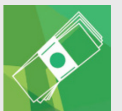


Special Report

# EU requirements for national budgetary frameworks: need to further strengthen them and to better monitor their application



EUROPEAN  
COURT  
OF AUDITORS

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## Executive summary

**I** Seeking to remedy the root causes of the financial crisis, the Commission saw the need to complement the rules-based fiscal framework with binding national provisions. It therefore proposed three legislative acts to strengthen national budgetary frameworks (i.e. the way budgetary policies are conducted). Two of these three acts have been adopted (in 2011, as part of the ‘Six-Pack’, and in 2013, as part of the ‘Two-Pack’), while the legislative process for a proposal for a directive from 2017 is still ongoing. Moreover, an intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union was signed in 2012 by 25 Member States.

**II** The legislative acts required Member States, among other things, to set up independent fiscal institutions, have in place national fiscal rules and introduce multi-annual rule-based budgetary frameworks. Well-designed independent fiscal institutions are associated with better compliance with fiscal rules and with accurate and less biased macroeconomic and budgetary forecasts, while medium-term budgetary frameworks are more generally recognised as contributing to stronger fiscal performance, as they show whether and how current policy decisions and future programmes fit within sustainable medium-term budget allocations.

**III** The audit was aimed at assessing whether the Commission’s actions to strengthen the EU Member States’ budgetary frameworks had achieved the intended results. To this end, we examined whether:

- (a) the EU legal requirements on national budgetary frameworks were effective;
- (b) the national budgetary frameworks were strengthened through appropriate and clear interaction between the Commission, the independent fiscal institutions and the European Fiscal Board;
- (c) the Commission assessed appropriately how the EU legal requirements have been implemented and applied in the Member States.

**IV** The EU’s legislative action provided impetus to strengthen national budgetary frameworks. However, the legal framework leaves room for improvement. When compared to international standards and best practices, the requirements are softer in several respects, particularly those regarding medium-term budgetary frameworks and independent fiscal institutions. The Directive proposed by the Commission in 2017 addresses some – but not all – of the weaknesses we observed.

**V** Independent fiscal institutions assess compliance with national fiscal rules. Moreover, as well as the Commission, some independent national fiscal institutions also assess the Member States' compliance with EU fiscal rules, either because they are obliged to do so by their own legal basis or because they chose to do so on a voluntary basis. The Commission's use of its discretionary powers as well as other factors imply a risk of inconsistency between Commission's and independent fiscal institutions' assessment of compliance with EU fiscal rules. Should the risk materialise, the effectiveness of the EU fiscal framework would be reduced.

**VI** The 'Five Presidents' report' published in 2015 proposed setting up a European Fiscal Board, which would provide a public and independent performance assessment, at European level, of national budgets and their execution against EU fiscal objectives. The Commission established it by means of a Decision in the same year. The set-up and mandate of the European Fiscal Board fell short of the tasks envisaged in this report. Moreover, the current institutional set-up leaves room for improvement regarding its independence. Finally, the Commission can ignore the proposals and recommendations issued by the European Fiscal Board without providing appropriate explanation.

**VII** The Commission has so far only limited assurance that the EU requirements for national budgetary frameworks are properly implemented and applied. Indeed, the assessment of the compliance of national laws with the requirements of Directive 2011/85 has not yet been completed. The assessments of the application of the EU legal framework have either not yet been carried out or came at too early a stage of implementation to be meaningful.

**VIII** We recommend that the Commission:

- (a) strengthen cooperation with the independent fiscal institutions in order to minimise divergences between the Commission's and the independent fiscal institutions' assessments of compliance with EU fiscal rules;
- (b) review requirements for national budgetary frameworks also taking into account international standards and best practices;
- (c) strengthen the European Fiscal Board;
- (d) address pending compliance issues and enhance assurance on the functioning of national budgetary frameworks.

# Introduction

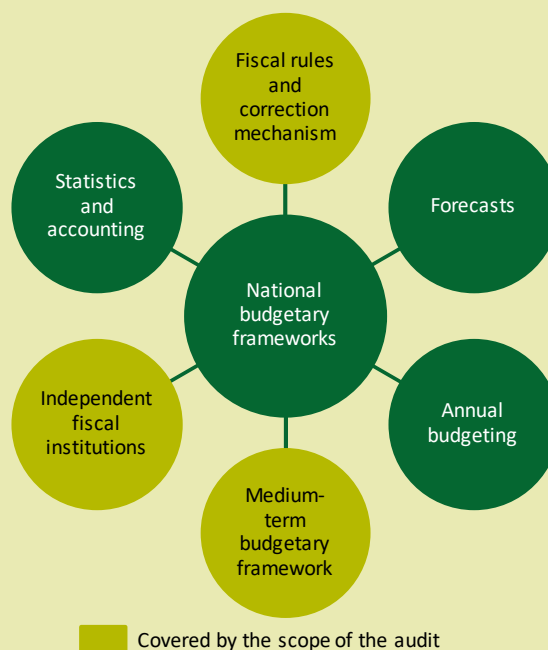
## Background

**01** As the outbreak of the sovereign debt crisis in 2009 threatened the stability of the euro area, the EU legislators adopted several legislative acts to improve the EU's fiscal governance. The aim was to enhance the implementation of the Stability and Growth Pact (SGP) and to strengthen the national budgetary frameworks (NBFs)<sup>1</sup> (see **Box 1** for the components of NBFs).

### Box 1 - National budgetary frameworks

NBFs are the arrangements, procedures, rules and institutions underlying budgetary policies.

#### Components of the NBFs



Source: ECA.

<sup>1</sup> European Council (2010), 'Report by the Task Force to the European Council on strengthening economic governance in the EU'.

**02** There is broad consensus in the economic literature that multi-annual, rule-based budgetary frameworks are associated with stronger fiscal performance<sup>2</sup>, as they show how current policy decisions and future programmes fit within sustainable medium-term budget allocations. Credible medium-term budgetary frameworks (MTBFs) can also help governments in reconciling requirements for fiscal sustainability with the possible use of fiscal policies to cushion the effects of economic and financial shocks<sup>3</sup>.

**03** Under the Treaty on the Functioning of the European Union (TFEU), Member States keep their sovereignty with regard to budgetary policies. Nevertheless, coordination of the policies is needed to avoid negative spill-overs and threats to monetary stability in the euro area. The Commission considered that for this coordination to be successful, EU budgetary goals must be embedded within national budgetary policies<sup>4</sup>. In 2005, “the Council considered that domestic governance arrangements should complement the EU framework”<sup>5</sup>. However, at that time, no all-encompassing analysis was provided of (i) weaknesses in the then-existing EU framework or (ii) the future coordination of the two governance arrangements. In October 2009, the Council of the EU (the “Council”) again concluded that NBFs should be strengthened to support long-term fiscal sustainability<sup>6</sup>.

**04** Since 2006, the Commission has been collecting, through surveys of relevant national authorities, qualitative information and data on the main elements of NBFs (i.e. numerical fiscal rules, independent fiscal institutions (IFIs) and MTBFs). This information feeds into the Commission’s Fiscal Governance Database and is used to calculate indices on the strength and quality of these elements.

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<sup>2</sup> For example: Debrun, X. and al. (2008), ‘Tied to the mast? National fiscal rules in the European Union’, economic policy 23/54, pp. 299-362.

<sup>3</sup> IMF (2013), ‘Reassessing the role and modalities of fiscal policy in advanced economies’, policy paper.

<sup>4</sup> See for example European Commission (2004), ‘Report on public finances in EMU 2004’.

<sup>5</sup> Council of the EU (2005), ‘Ecofin Council report to the European Council of 22-23 March 2005 on improving the implementation of the Stability and Growth Pact’.

<sup>6</sup> Council of the EU (2009), ‘2967th Economic and Financial Affairs Council conclusions on fiscal exit strategy’.

## Legal framework

**05** The first step, as a result of political discussions, in developing a common legal framework was the adoption of Directive 2011/85<sup>7</sup>, one of six legislative measures known as the ‘Six-Pack’. Directive 2011/85 lays down minimum requirements for the NBFs (for an overview of relevant legal acts and the history of their approval, see [Annex I](#)):

- (i) Member States’ fiscal planning should be based on realistic macroeconomic and budgetary forecasts provided by a designated institution;
- (ii) Member States should have specific fiscal rules, compliance with which is to be monitored by independent bodies;
- (iii) Member States should have a credible and effective MTBF that includes a minimum three-year fiscal planning horizon and
- (iv) Member States should have comprehensive, consistent and transparent systems for budgetary accounting and statistical reporting.

**06** The second step was the inter-governmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG), signed in March 2012, and in particular, the Fiscal Compact (Title III), complemented by a Commission Communication setting out seven common principles<sup>8</sup> in June 2012 (the “Commission’s common principles”). The contracting parties bound by the Fiscal Compact (all 19 euro-area Member States, Bulgaria, Denmark and Romania) are required to enshrine in national legislation a structural balanced-budget rule and to set up an automatic correction mechanism, as well as an IFI (see [Box 2](#)).

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<sup>7</sup> Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, OJ L 306, 23 November 2011 (referred to in this document as Directive 2011/85).

<sup>8</sup> European Commission (2012), COM(2012) 342 final, ‘Communication from the Commission, Common principles on national fiscal correction mechanisms’.



## Box 2 - Concepts explained

**Structural balance:** The actual budget balance net of the cyclical component and one-off and other temporary measures. The structural balance gives a measure of the underlying trend in the budget balance.

**Balanced budget rule:** The budgetary position of the general government must be balanced or in surplus. In both the SGP and the TSCG, this rule is deemed to be complied with if the annual structural balance of the general government is at its medium-term budgetary objective (MTO). The SGP specifies -1 % of Gross Domestic Product (GDP) as the lower limit of the structural balance for the euro area Member States, which the Fiscal Compact tightens further to -0.5 % (except for Member States with low debt and low sustainability risk).

**Automatic correction mechanism:** An obligation to implement corrective measures that is automatically triggered in the event of significant observed deviations from the medium-term budgetary objective or the adjustment path towards it.

**07** Well-designed IFIs are generally seen as being associated with better fiscal performance<sup>9</sup>, better compliance with fiscal rules<sup>10</sup> and more accurate and less biased macroeconomic and budgetary forecasts<sup>11</sup>.

**08** The third step was the adoption of Regulation 473/2013<sup>12</sup>, which forms part of the Two-Pack and was meant, among other things, to incorporate into EU law the provisions of the TSCG for the euro-area Member States.

<sup>9</sup> Debrun, X. and Kinda, T. (2014), 'Strengthening post-crisis fiscal credibility: Fiscal Councils on the rise — A new dataset', IMF working paper 14/58.

<sup>10</sup> Beetsma, R. and al. (2018), 'The rise of independent fiscal institutions: recent trends and performance', IMF working paper 18/68.

<sup>11</sup> Jonung, L. and Larch, M. (2006), 'Improving fiscal policy in the EU: the case for independent forecasts', economic policy 21/47, pp. 492-534.

IMF (2013), 'Case studies of fiscal councils — functions and impact'.

<sup>12</sup> Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, OJ L 140, 17 May 2013 (referred to in this document as Regulation 473/2013).

**09** Finally, the Commission submitted a proposal for a Directive to the Council in December 2017 with the aim of incorporating the substance of the TSCG into EU law<sup>13</sup> (the “2017 draft Directive”). At the time of writing this report, the adoption process at the Council was on hold pending the Commission’s assessment of the Six- and Two-Packs, which is due by the end of 2019<sup>14</sup>. The European Parliament has not yet issued its opinion on the proposal either.

**10** In 2015, the Commission established the European Fiscal Board (EFB) by means of a Decision (the “EFB Decision”)<sup>15</sup>. This was based on a recommendation made in the ‘Five Presidents’ report’<sup>16</sup> to create an advisory EFB to strengthen the EU governance framework, among other things by coordinating and complementing the national IFIs and by providing public and independent performance assessment of budgets and their execution against EU fiscal objectives.

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<sup>13</sup> European Commission (2017), COM(2017) 824 final, ‘Proposal for a Council Directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States’, p. 3.

<sup>14</sup> Economic and Financial Committee (2019), ‘Draft supplementary EFC findings on the transposition of the Fiscal Compact’, ecfm.cfm.cpe(2019)1812588.

<sup>15</sup> Commission Decision (EU) 2015/1937 of 21 October 2015 establishing an independent advisory European Fiscal Board; and Commission Decision (EU) 2016/221 of 12 February 2016 amending Decision (EU) 2015/1937 establishing an independent advisory European Fiscal Board.

<sup>16</sup> Juncker, J.-C., Tusk, D., Dijsselbloem, J., Draghi, M. and Schulz, M. (2015), ‘The Five Presidents’ report: Completing Europe’s Economic and Monetary Union’.

## Audit scope and approach

**11** Between 2016 and 2018, we examined both the corrective<sup>17</sup> and the preventive arm<sup>18</sup> of the SGP, as well as the macroeconomic imbalance procedure<sup>19</sup>. In order to complete our picture of the EU economic governance, we decided to carry out an audit on arrangements related to fiscal stability.

**12** The audit was aimed at assessing whether the Commission's actions to strengthen the budgetary framework of EU Member States, with reference to the three key components of (i) the fiscal rules and correction mechanism, (ii) MTBFs and (iii) IFIs (see **Box 1**), had achieved the intended results. To this end, we examined whether:

- (a) the EU legal requirements on NBFs were effective;
- (b) the NBFs were strengthened through appropriate and clear interaction between the Commission, the IFIs and the EFB and
- (c) the Commission assessed appropriately how the EU legal requirements have been implemented and applied in the Member States.

**13** We focused on the cases of the eight Member States in our audit sample (Greece, Spain, France, Italy, Latvia, Luxembourg, Portugal and the Netherlands)<sup>20</sup>. Nevertheless, our analysis also addressed, where necessary, the cases of other Member States. We also analysed the role and position of the EFB in the EU fiscal framework.

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<sup>17</sup> ECA special report 10/2016 'Further improvements needed to ensure effective implementation of the excessive deficit procedure' (<http://eca.europa.eu>).

<sup>18</sup> ECA special report 18/2018 'Is the main objective of the preventive arm of the Stability and Growth Pact delivered?' (<http://eca.europa.eu>).

<sup>19</sup> ECA special report 03/2018 'Audit of the Macroeconomic Imbalance Procedure (MIP)' (<http://eca.europa.eu>).

<sup>20</sup> These were euro-area Member States selected either because they had high debt, because their budgetary frameworks had shown significant improvement or because they had had an IFI in place for a long time.

**14** We derived our audit criteria from various sources: (i) legal documents; (ii) Commission documents and benchmarks; and (iii) documents issued and standards developed by different EU Institutions, other international organisations or researchers. Further details are provided in the relevant sections of this report.

**15** We collected our audit evidence based on:

- (a) a review of relevant Commission and EFB documentation;
- (b) a review of publications, guidelines and standards from international organisations (the IMF, the OECD, the World Bank) as well as relevant independent institutes and academic literature;
- (c) an online survey of IFIs in the EU to which 31 IFIs from 26 Member States<sup>21</sup> responded;
- (d) interviews with staff from the Directorate-General for Economic and Financial Affairs (DG ECFIN);
- (e) interviews with staff from relevant Ministries, IFIs, Central Banks and think tanks in our sample of eight Member States to obtain feedback on the EU requirements and their application.

**16** This special report is intended to contribute to the discussions at the European Parliament and the Council on the 2017 draft Directive on strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States as proposed by the Commission.

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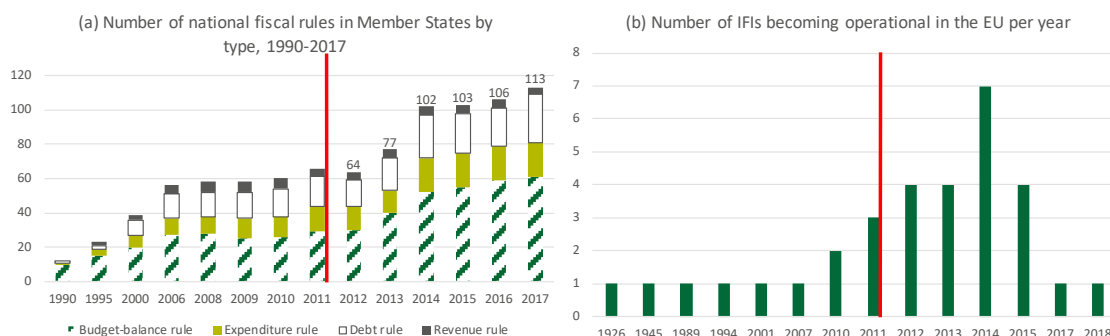
<sup>21</sup> In 5 of the 28 Member States, 2 institutions share the tasks of an IFI.

## Observations

### The EU legal requirements provided impetus for improving national budgetary frameworks but leave room for improvement

**17** As expected, the EU legislative actions (see paragraphs 05 to 10) provided an impetus to strengthening NBFs in EU Member States. As [Figure 1](#) illustrates, the number of national fiscal rules and IFIs have increased significantly following the adoption of Directive 2011/85.

**Figure 1 – National fiscal rules and IFIs in the EU Member States**



*Note:* In 2011 (red line), Directive 2011/85 was adopted.

*Source:* ECA based on Commission's data.

**18** However, the different elements of NBFs are currently governed by a fragmented legal framework (see [Figure 2](#)). These different elements are: (i) the numerical fiscal rules, (ii) the correction mechanism, (iii) the MTBFs, (iv) the IFIs, and (v) the budgetary procedures.

**Figure 2 – Fragmentation of legal framework**

		Directive 2011/85	Fiscal Compact	Regulation 473/2013	2017 draft Directive
National budgetary frameworks	Numerical fiscal rules				
	Correction mechanism				
	MTBF				
	IFIs				
	Budgetary procedures				
Applicability to Member States		28*	22 (including 19 euro-area Member States)	19 euro-area Member States	-

Focused on
  Only vaguely referred to
  No new requirements

Source: ECA, \* Some provisions are not applicable for the United Kingdom.

**19** Various acts of different legal nature (EU law and Intergovernmental Treaty) coexist:

- their degree of enforceability varies (the Court of Justice of the EU can only rule on the transposition of the TSCG; in relation to the application of the TSCG, the EU institutions do not have any power to ensure that the national legislation transposing it is enforced);
- while certain provisions are enshrined in regulations, which are directly applicable, others are set out in a directive, which Member States are given time to transpose and are free to decide how to apply, resulting in greater heterogeneity of national frameworks;
- the degree of applicability to certain Member States varies, in particular depending on whether they are in the euro area.

**20** The Commission drafted Directive 2011/85 within a very short period of time (three months). It emphasised that Directive 2011/85 should be regarded as a set of “minimum requirements”, rather than as representing best practice, or even the desirable features for an MTBF. It stated that embedding best practices into the EU legal framework “would not have been compatible with the considerable differences across Member States' administrative and institutional structures”<sup>22</sup>.

<sup>22</sup> European Commission (2012), ‘Report on public finances in EMU 2011’, p. 101.

**21** As mentioned in paragraph 09, the 2017 draft Directive was meant to incorporate the substance of the TSCG into EU law. The Commission did not opt for a word-by-word transposition but for what it calls a “teleological approach”, i.e. incorporation focusing on the Fiscal Compact's underlying objective: convergence to prudent levels of public debt. In practice, the 2017 draft Directive requires, among other things, an MTO in terms of a structural balance that ensures compliance with the debt-to-GDP ceiling enshrined in the TFEU, but without setting any numerical ceiling.

**22** The European Central Bank (ECB) stated in an opinion that “the provisions of this Directive deviate substantially from those of the Fiscal Compact, which may lead to a weakening of the rules of the Fiscal Compact”<sup>23</sup>. In addition, it should be noted that the 2017 draft Directive was proposed before carrying out the review of the suitability of Directive 2011/85 (the “suitability review”) or the assessment on the functioning of the Two-Pack.

**23** We assessed whether requirements in the current legal framework were appropriate and whether the 2017 draft Directive addressed any identified shortcomings. We did this for the following three aspects:

- (a) correction mechanism;
- (b) medium-term budgetary frameworks;
- (c) independent fiscal institutions.

### Shortcomings in the provisions on the correction mechanism

**24** Directive 2011/85 introduced for the first time the concept of a correction mechanism, referred to as “the consequences in the event of non-compliance”. Beyond this, however, it did not lay down specific requirements regarding its design and application.

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<sup>23</sup> ECB (2018), CON/2018/25.

**25** The TSCG requires an automatic triggering of the correction mechanism in case of significant observed deviations from the MTO. It does not directly lay down specific requirements on the design and application of the mechanism, but tasked the Commission with producing common principles, which Member States should apply in designing national correction mechanisms. The Commission issued these principles in June 2012.

**26** Despite being endorsed at a political level<sup>24</sup>, the principles are not binding as they were published in a Commission Communication and thus have no legal effect other than serving as a basis for the mechanisms the contracting parties were to put in place. As regards the activation of the correction mechanism (principle 3), the Commission has suggested that the correction mechanism's trigger points could rely on either EU-level criteria, country-specific criteria, or both. However, two-thirds of Member States opted to mirror the EU-level criteria rather than having specific national ones. As a result, for these Member States, national correction mechanisms are unlikely to be triggered earlier than the EU correction mechanism under the preventive arm of the SGP.

**27** Regulation 473/2013 lays down certain requirements, including the requirement that independent bodies should provide, where appropriate, assessments regarding the triggering and implementation of correction mechanisms. However, it does not fully reflect the Commission's common principles, which had been issued half a year after the Commission's proposal for Regulation 473/2013. For example, it does not indicate that:

- the correction should be consistent with any recommendations made by the Commission to the Member State concerned under the SGP in terms of size and timeline (principle 2);
- activation triggers may comprise EU-driven or country-specific criteria (principle 3);
- larger deviations from the MTO or the adjustment path towards it should lead to larger corrections (principle 4).

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<sup>24</sup> European Commission (2017), C(2017) 1201 final, 'Report from the Commission presented under Article 8 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union', p. 3.



**28** The 2017 draft Directive likewise does not fully reflect the Commission’s common principles. For example, it omits to mention that the correction mechanism’s trigger points may rely on either EU-level criteria, country-specific criteria, or both.

**29** Lastly, as highlighted by the ECB, the 2017 draft Directive does not define the term “significant observed deviation”, i.e. the circumstances under which the mechanism is to be activated, and does not contain any further guidance regarding its scope. The requirement to take into account the nature and size of a deviation is vague, and may result in correction measures that are very broad and lacking in substance<sup>25</sup>.

### **Shortcomings in the provisions on medium-term budgetary frameworks**

**30** We compared the requirements set by Directive 2011/85 with the standards and best practices recommended by the IMF, the OECD and the World Bank at the time Directive 2011/85 was drafted. Three of these standards and best practices were not taken up in Directive 2011/85 (see [Table 1](#), lines in bold). Compared with the latest IMF/OECD standards and best practices, Directive 2011/85 falls short in respect of two more issues. Thus, in total, 5 out of the 13 standards and best practices were not reflected in Directive 2011/85. This is despite the fact that, at the time Directive 2011/85 was drafted, the Commission’s views on these issues (see [Annex II](#)) were in line with those of international bodies.

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<sup>25</sup> ECB (2018), CON/2018/25.

**Table 1 – Differences between IMF/OECD standards and best practices and Directive 2011/85 requirements**

MTBF Characteristics	IMF/OECD	Directive 2011/85
At least 3-year MTBF framework	✓	✓
Comprehensive coverage of general government	✓	✓
Full alignment with government's fiscal policy objectives and macroeconomic forecasts	✓	✓
Projections of future revenue and expenditure at current policies distinct from fiscal impact of new policy measures	✓	✓
Estimated cost of tax expenditure	✓	✓
Budget preparation process for capital and recurrent spending fully integrated	✓	✓
Reliable forward estimates of spending in out-years <sup>26</sup>	✓	✓
Assessment of long-term sustainability of public finance	✓	✓
<b>A single process for preparing MTBF and annual budget, and fully integrated documentation</b>	✓	✗
<b>Forward-looking expenditure controls (carryovers, multiyear expenditure commitments, buffers, etc.)</b>	✓	✗
<b>Monitoring and accountability mechanisms</b>	✓	✗
Indicative ceilings for out-years	✓	✗
Spending estimates for out-years rolled over from one MTBF to the next	✓	✗

Note: ✓ : included, ✓ : partially included, ✗ : not included

Source: ECA based on OECD (2004), 'The Legal Framework for Budget Systems'; IMF (2007), 'Manual on Fiscal Transparency'; IMF (2010), Lienert, I. and Fainboim, I., 'Reforming Budget Systems Laws'.

<sup>26</sup> Any year beyond the current budget/fiscal year.

**31** According to an IMF paper, the lack of integration between medium-term expenditure planning and the budgeting process makes medium-term planning ineffective in constraining fiscal policy<sup>27</sup>. However, while article 10 of Directive 2011/85 requires annual budget legislation to be consistent with provisions of the MTBF or duly explain any departure, there is no requirement for an integrated medium-term expenditure planning and budgeting process<sup>28</sup>. Moreover, it does not require that budget documentation include projections and outturns of revenues, expenditures and financing over the medium term on the same basis as the annual budget<sup>29</sup>.

**32** Also, according to an IMF paper, four types of forward-looking control mechanisms are important: (i) controls over the accumulation, stock, or drawdown of carryovers, (ii) regular monitoring of consistency of updated medium-term expenditure projections with approved medium-term plans, (iii) sufficient margins between expenditure commitments and expenditure plans to absorb unexpected events without requiring reprioritisation of policies, and (iv) firm controls on ministries' and agencies' ability to enter into multi-year expenditure commitments. However, Directive 2011/85 does not provide for the establishment of forward-looking expenditure controls to ensure compliance with the medium-term plans even as external conditions change.

**33** Lastly, Directive 2011/85 does not contain any provision addressing the need for national authorities to report budgetary outturns on a comparable basis with multi-year plans, and to comprehensively and transparently reconcile any deviation between multi-year plans and expenditure outcomes. Moreover, there is no specific provision requiring governments or those involved in budgetary implementation to be held accountable for any unjustified deviations from multi-year plans.

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<sup>27</sup> IMF (2013), Cangiano, G. et al., 'Public Financial Management and its emerging architecture', p. 161.

<sup>28</sup> OECD (2004), 'The Legal Framework for Budget Systems', Box III.4; IMF (2010), Lienert, I. and Fainboim, I., 'Reforming Budget Systems Laws', Box 4 and pp. 12-13; IMF (2013), Cangiano, G. et al., 'Public Financial Management and its emerging architecture', p. 156; IMF (2014), 'Fiscal transparency code', Principles 2.1.3, 2.3.1 and 2.3.2; World Bank (2013), 'Beyond the annual budget. The global experience with medium term expenditure frameworks', pp. 58-59.

<sup>29</sup> IMF (2014), 'Fiscal transparency code', Principle 2.1.3.

**34** The 2017 draft Directive introduces the requirement for a binding medium-term expenditure rule set out at the beginning of the legislature. Such a rule would provide more stability for budgetary planning and strengthen the link between budget and MTBF. However, it might put fiscal stability at risk if the growth of expenditure deviates from the potential output<sup>30</sup> growth. The 2017 draft Directive did not address any of the other shortcomings<sup>31</sup> indicated in *Table 1*.

### Shortcomings in the provisions on the independent fiscal institutions

**35** Regulation 473/2013, which is binding for the euro-area Member States, defines the functions that IFIs should assume, as well as features and principles. The latter are in line with the Commission's common principles. They were added in the course of the legislative process as the principles were adopted after the Commission made its proposal for a regulation.

**36** We compared the provisions on IFIs with the international standards and best practices of the IMF<sup>32</sup> and the OECD<sup>33</sup>. We observed that EU law lacks requirements with regard to (i) the number and length of the terms of the IFI board members, (ii) IFIs' human resources policies, (iii) the establishment of the IFIs' budgets, and

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<sup>30</sup> The potential output is a theoretical concept of the level of output (GDP) at a given moment that is consistent with stable inflation. It grows in time at a rate that is not necessarily constant. Both the level and the growth rate cannot be measured directly, but have to be estimated.

<sup>31</sup> The IMF and the OECD updated their standards and best practices for good budgetary governance in 2014 and 2015 respectively to incorporate lessons learnt from the economic and financial crisis. However, the Commission did not reflect this update in the 2017 draft Directive.

<sup>32</sup> IMF (2013), 'The functions and impact of fiscal councils': "This paper provides the most comprehensive survey of fiscal councils available so far" and also builds on other papers including the OECD's 2012 draft principles and Kopits, G. (2011), 'Independent fiscal institutions: Developing good practices', pp. 35-52.

<sup>33</sup> OECD principles were already available in 2012 and were adopted in 2014. See OECD (2014), 'Recommendation on Principles for IFIs'.

(iv) the need for external review. This resulted in heterogeneous IFIs being established, as illustrated by *Annex III* and also highlighted in a Commission discussion paper<sup>34</sup>.

**37** As far back as 2004, the Commission<sup>35</sup> highlighted the importance of both macroeconomic and budgetary forecasts being either produced or assessed by an independent institution in order to reduce and possibly eliminate their optimism bias<sup>36</sup>. This was also later confirmed by IMF<sup>37</sup> and OECD<sup>38</sup> papers. Despite the Commission's proposal to include both, Regulation 473/2013, in its adopted form, requires only macroeconomic forecasts to be either produced or endorsed by the IFIs, but not the budgetary forecasts (i.e. projected budgeted revenue and expenditure).

**38** The 2017 Commission discussion paper (see paragraph **36**) took the view, among other things, that IFIs could be given a more extensive role in producing or endorsing budgetary forecasts, given their role in relation to macroeconomic forecasts. IFIs and other stakeholders we met also emphasised this limitation with regard to the budgetary forecasts.

**39** In 2016, the Network of EU IFIs, a platform for exchanging views and expertise and pooling resources, proposed a list of minimum standards for IFIs similar to the OECD's principles, as well as the establishment of "an effective system for their safeguarding"<sup>39</sup>. However, the 2017 draft Directive does not address these issues: in terms of standards, the only new requirement in the 2017 draft Directive is for Member States to ensure that IFIs comply with the principles for IFIs set in Regulation 473/2013.

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<sup>34</sup> European Commission (2017), Jankovics, L. and Sherwood, M., 'Independent fiscal institutions in the EU Member States: The early years', discussion paper 067.

<sup>35</sup> European Commission (2004), Jonung, L. and Larch, M., 'Improving fiscal policy in the EU: the case for independent forecasts'.

<sup>36</sup> Optimism bias is the practice of overestimating growth in output and revenue while underestimating non-discretionary expenditure.

<sup>37</sup> IMF (2007), 'Code of good practices on fiscal transparency', Principle 4.3.4.

<sup>38</sup> OECD (2014), 'Recommendation on Principles for IFIs', Principle 3.3.

<sup>39</sup> Network of EU IFIs (2016), 'Defining and enforcing minimum standards for IFIs'.

**40** The Network of EU IFIs, while welcoming this new requirement, asked for the “conditions spelled out in the [2017 draft Directive]” to “be complemented with a clearer definition of minimum standards and an effective system for their safeguarding”<sup>40</sup>. The Network of EU IFIs even suggested in this statement that the “proposal could additionally oblige Member States to ensure an ambitious implementation of this principle in national legislation by fixing the procedure and minimum requirements”. In January 2019, the Network of EU IFIs reiterated its call for “the development and incorporation possibly into EU legislation of adequate standards for the design and operative capacity of IFIs”.

**41** Lastly, we acknowledge that the 2017 draft Directive envisaged a wider role for IFIs by charging them (i) to critically assess both ex-ante and ex-post the adequacy of the MTO and the medium-term net expenditure path, (ii) to call for the activation of the correction mechanism and (iii) to monitor its application and outcome. Moreover, the 2017 draft Directive aimed to introduce in EU law the ‘comply-or-explain’ principle.

### **Inconsistent assessment and weak design create risks for independent fiscal institutions and the European Fiscal Board**

**42** EU legislation requires Member States to have in place national fiscal rules and assigns distinct monitoring roles to the Commission and to the IFIs. While the Commission assesses compliance of draft budgetary plans with EU fiscal rules, IFIs assess compliance with national fiscal rules. However, the EU law does not provide for a ‘two-tier’ governance structure, where the Commission, for its monitoring role, would rely on the work done by the national IFIs.

**43** The EFB was set up with the aim of strengthening the current economic governance framework (see paragraph 10). Its tasks consist among other things in providing an evaluation of the implementation of the EU fiscal framework and the appropriateness of the actual fiscal stance at euro-area and national level.

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<sup>40</sup> Network of EU IFIs (2018), Statement by the Network of EU IFIs in response to the Proposal for a Council Directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in Member States.

**44** We therefore assessed whether:

- (a) there was consistency between the Commission and the IFIs in assessing compliance with EU fiscal rules;
- (b) the EFB was in a position to provide independent opinions.

### **Risk of inconsistency between Commission's and independent fiscal institutions' assessments on compliance with EU fiscal rules**

**45** EU law is not prescriptive regarding national fiscal rules (e.g. with regard to number, type and design features) but stipulates that they should effectively promote compliance with the reference values on deficit and debt set in accordance with obligations from the TFEU. In practice, the parties to the Fiscal Compact (see paragraph [06](#)) adopted national fiscal rules closely linked to those of the preventive arm of the SGP.

**46** The TSCG, as the preventive arm of the SGP, requires a budgetary position that is “balanced or in surplus”, meaning a structural balance equal to or greater than the MTO, or in line with the adjustment path towards it. Moreover, progress towards, and fulfilment of, the MTO must be evaluated based on an analysis of compliance with the expenditure benchmark of the SGP, i.e. expenditure should not grow faster than the potential output ([Annex IV](#) compares the rules of the SGP preventive arm with those of the TSCG).

**47** Moreover, in some Member States (e.g. Italy and Portugal), IFIs are mandated to assess compliance with EU fiscal rules. Some IFIs without such mandate (e.g. France's) do this on a voluntary basis. Our survey of IFIs showed that half of them monitored compliance with EU numerical fiscal rules.

**48** The IFIs we surveyed considered that their assessment of compliance with EU fiscal rules did not lead to a duplication of roles with the Commission but rather was complementary, as it may foster national ownership of EU fiscal rules. Our interviews with the IFIs confirmed their replies. However, IFIs that only monitor compliance with national fiscal rules are not in favour of also monitoring compliance with the EU fiscal rules. One of the reasons they gave for this was reputational risk in the event of diverging assessments.

**49** When the Commission and IFIs both assess compliance with EU fiscal rules, they may indeed come to different conclusions. One reason is that the Commission, as we have already observed in our special report 18/2018, made extensive use of its margin of discretion<sup>41</sup> when assessing compliance with the EU fiscal rules (i.e. compliance with the adjustment path towards the MTO).

**50** Also, the Regulation establishing the SGP allows for a relatively large margin of deviation from a Member State's annual benchmark<sup>42</sup> by allowing a number of factors to be considered in the assessment of compliance with fiscal rules. Examples of such factors are:

- (i) the implementation of major structural reforms;
- (ii) unusual events;
- (iii) the need for public investment;
- (iv) unspecified "other factors".

**51** Thus, even when a Member State significantly deviates from its required fiscal adjustments (i.e. reduction in government deficit), the Commission might eventually conclude not to take any action and consider the Member State compliant with the EU fiscal rules.

**52** These issues were also mentioned by IFIs, in their replies to our ECA survey, as weaknesses, which might affect their work. About 40 % of the responding IFIs considered that these issues may potentially result in their assessment of compliance with the MTO or the adjustment path towards it differing from the Commission's (see [Figure 3](#)).

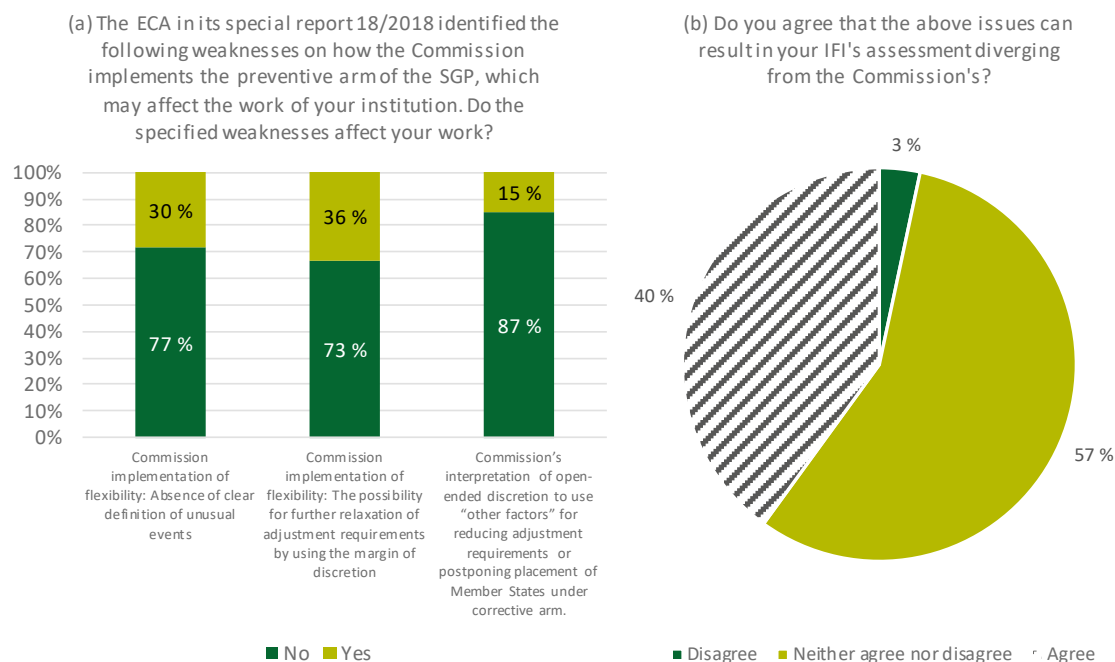
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<sup>41</sup> In 2015, the Commission published an interpretative Communication on its margin of interpretation, "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact" COM(2015)12 final. This was subsequently reflected in the commonly agreed position of November 2015 endorsed by the Council in February 2016.

<sup>42</sup> To achieve fast convergence towards the MTO, the benchmark set by the SGP is that Member States should adjust their structural budgetary positions at a rate of 0.5 % of GDP per year.



**Figure 3 – Replies to ECA survey of IFIs**



Source: ECA survey.

**53** Other reasons for divergences (see paragraph 49) are IFIs using their own (i) methodology for calculating the potential output and/or (ii) assumptions and datasets. However, the Commission has enhanced its cooperation with IFIs, by explaining its own methodology to help prevent such divergences.

**54** Lastly, the Commission's conclusions on Member States' compliance with EU fiscal rules may take into account discussions between the Commission and that country's government, in which the IFIs do not take part.

**55** The risk of inconsistency between the conclusions reached by IFIs and by the Commission has already been mentioned by the EFB<sup>43</sup> and confirmed by our survey. Indeed, 20 % of the IFIs indicated that they had already experienced such differences. **Box 3** provides examples of differing conclusions.

<sup>43</sup> EFB (2018), Annual report 2018, p. 42.

### Box 3 – Commission and IFI assessments with different conclusions – Examples

In its fiscal assessment report of November 2016, the Irish IFI (the Irish Fiscal Advisory Council - IFAC) mentioned that Ireland's 2017 draft budgetary plan showed "non-compliance with the budgetary rule requirements of the domestic Fiscal Responsibility Act and EU preventive arm for 2016 and 2017"<sup>44</sup>. The Commission, however, considered it broadly compliant with the provisions of the SGP.

The French IFI (the Haut Conseil des finances publiques – HCFP), in its assessment of the French draft budgetary plan in September 2018, stressed that "the structural adjustments planned for 2018 (0.1 percentage point of GDP) and 2019 (0.3 percentage point of GDP), which will be submitted to the Commission for assessment, do not comply with the rules of the preventive arm of the SGP". However, the Commission's opinion on this draft budgetary plan was less clear-cut as France was assessed as "at risk of non-compliance".

## Establishing the European Fiscal Board was a good step, but there is room for strengthening its role and independence

**56** The 'Five Presidents' report' envisaged the following tasks for the EFB:

- to coordinate the network of national fiscal councils and conform to the same standard of independence;
- to advise on but not implement policy. Enforcing the rules should remain the task of the Commission, which should be able to deviate from the views of the EFB provided that it has justifiable reasons and explains them;
- to form an economic, rather than a legal, judgement on the appropriate fiscal stance, both at national and euro-area level, against the backdrop of EU fiscal rules. This should be done on the basis of the rules set in the SGP;
- to be able to issue opinions when it considers this necessary, including in particular, in connection with the assessment of stability programmes and presentation of the annual draft budgetary plans, and the execution of national budgets;

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<sup>44</sup> Irish Fiscal Advisory Council (2016), 'Fiscal assessment report', p. 67.

- o to provide an ex-post evaluation of how the governance framework was implemented.

**57** However, in the EFB Decision, the Commission left out most of the national dimension of these tasks. In particular, it did not task the EFB with issuing opinions on national stability or convergence programmes, draft budgetary plans or the execution of national budgets. Moreover, rather than coordinating the IFIs, it stated that the EFB should merely cooperate with them. We note that IFIs themselves argued against coordination by the EFB because they saw it as going against the goal of increasing national ownership and damaging their independence.

**58** In a speech in November 2015, the President of the Eurogroup considered that there were “merits in having a big European sister of the national fiscal councils, placed outside the Commission to provide independent assessments of the national draft budgets, on the basis of which the Commission gives its (political) opinion”.

**59** Furthermore, the ‘Five Presidents’ report’ had called for the EFB to “conform to the same standard of independence” as national IFIs as set in Regulation 473/2013.

**60** Article 4 of the EFB Decision states that the members of the Board shall act independently. However, the EFB’s independence is limited by its weak statutory regime and scarce resources<sup>45</sup>:

- the Chair and the four members of the Board are appointed by the Commission. Their mandate is part-time, short (three years) and renewable once, and there is no provision for their removal (such as removal only in the event of incapacity or serious misconduct);
- since they were established by a Commission Decision, the Commission can amend the rules governing the EFB;

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<sup>45</sup> The EFB consists of a Board and a Secretariat (staffed by a Head of Secretariat and dedicated supporting staff currently limited to five economists and one assistant).

- (c) the EFB has no financial independence, as it does not have its own budget and cannot freely manage its human resources. Its budget falls under the “Euro and Social Dialogue” budget of the cabinet of the Vice-President of the Commission and covers the salaries of the members (who have the status of special advisors) and the costs of their business trips. The Secretariat of the EFB is a unit of the Commission’s Secretariat-General. As such, its expenses (business trips, invitation of experts, organisation of workshops, etc.) are covered by the operational budget of the Secretariat-General;
- (d) the EFB is attached to and located in the premises of the Secretariat General of the Commission, and its website is also hosted by the Commission.

**61** The above mentioned factors result in a weak institutional set-up, as also pointed out by the ECB: “the creation of the European Fiscal Board on the basis of a Commission decision within its organisational structure is not in line with the standards established for its counterparts at the national level”<sup>46</sup>. The same issue was raised by the IMF<sup>47</sup>.

**62** Moreover, whereas the ‘Five Presidents’ report’ stipulates that the EFB “should be able to issue opinions when it considers it necessary”, the EFB Decision only makes reference to the publication of an annual report. It does not explicitly mention the option of the EFB publishing assessments in real time or issuing public opinions, which in any case is hampered by its limited resources.

**63** In practice, the EFB publishes two types of regular reports (1) the EFB’s assessment of the fiscal stance appropriate for the euro area published in June and (2) an annual report, published at the end of the year. In addition, the EFB has recently published an assessment of EU fiscal rules<sup>48</sup>.

**64** Our assessment of the four reports issued in 2017 and 2018 is that they are of good analytical quality. This was confirmed by stakeholders we met in the sampled Member States and by our survey of the IFIs. Indeed, 87 % of IFIs assessed the quality

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<sup>46</sup> ECB (2015), ‘Economic Bulletin’, Issue 7, Box 5: The creation of a European Fiscal Board.

<sup>47</sup> IMF (2016), ‘2016 Article IV consultation – euro-area policies’, IMF country report 16/219, p. 20.

<sup>48</sup> The EFB also published one statement in support of the Danish Fiscal Council in March 2018.

of the analysis in the EFB reports as ‘good’, with 10 % describing it as ‘average’ and only 3 % as ‘poor’.

**65** In the annual report, the EFB provides an evaluation of the implementation of the Union fiscal framework. It also issues, in a dedicated section, proposals for the future evolution of the Union fiscal framework. However, while the annual reports also contained an evaluation of selected efficiency aspects regarding IFIs, such as their application of the ‘comply-or-explain’ principle and whether their right to access information was guaranteed, the dedicated section on proposals did not include anything on how to improve the IFIs’ situation.

**66** Moreover, the EFB Decision does not specify how the EFB’s proposals would feed into the Commission’s internal decision-making process. In fact, the Commission can ignore the EFB’s proposals issued without providing any reason since, contrary to what was proposed in the ‘Five Presidents’ report’, it is not bound by the ‘comply-or-explain’ principle. This issue has been pointed out both by the ECB<sup>49</sup> and by the European Ombudsman<sup>50</sup>.

**67** In his reply to the European Ombudsman, the Vice-President of the European Commission explained that a strict parallel cannot be drawn between the EFB and national IFIs. National IFIs are watchdogs for monitoring whether national policies are compliant with the fiscal rules. The EFB does not monitor the EU budget or its implementation - it is an independent advisory body of the Commission. This is why the Vice-President of the European Commission argued that the ‘comply-or-explain’ principle does not apply in this context.

**68** The quality of the analysis and the critical views expressed by the EFB indicate that, despite being embedded within the Commission, it has been able to form independent opinions. However, this independence relies solely on the EFB’s current membership rather than its institutional set-up. Our survey showed that the IFIs’ perception of the EFB’s independence was mixed: 53 % of them consider the EFB to have ‘limited independence’, whereas 47 % consider it to be ‘fully independent’.

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<sup>49</sup> ECB (2015), ‘Economic Bulletin’, Issue 7, Box 5: The creation of a European Fiscal Board.

<sup>50</sup> European Ombudsman (2016), ‘Letter from the European Ombudsman to the President of the European Commission regarding Transparency of the European Fiscal Board’.

## The Commission so far has only limited assurance that national budgetary frameworks are properly implemented and applied

**69** The initial requirements for Member States' budgetary frameworks were not set out in a regulation, but took the form of a directive. Consequently, implementing these requirements takes longer and Member States have discretion as regards how to do so.

**70** However, the Commission stated in the report "public finances in EMU 2011" (published in 2012)<sup>51</sup> that the choice of a directive "responded to the need to achieve balance in Member States' requirements".

**71** We assessed whether:

- (a) the Commission was able to reach timely conclusions on the compliance of national legislation with EU requirements;
- (b) the Commission's assessment provided meaningful insights into the implementation and application of NBFs.

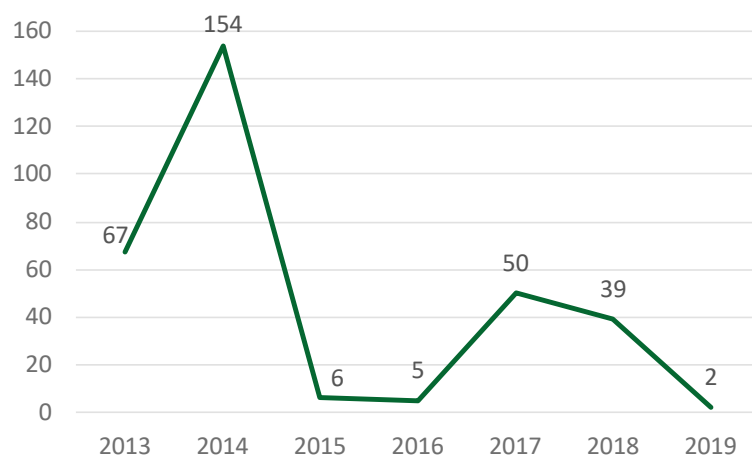
### Delays in concluding on the compliance of national legislation with EU requirements due to factors not all under the Commission's control

**72** The deadline for transposing Directive 2011/85 was 31 December 2013. Member States had to notify their national implementing measures to the Commission. Member States issued 323 national implementing measures, but only 67 of them (20 %) were notified in time (see [Figure 4](#)). In fact, Member States had to simultaneously incorporate into national law not only the requirements of Directive 2011/85, but also those stemming from Regulation 473/2013 and the Fiscal Compact.

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<sup>51</sup> European Commission (2012), 'Report on public finances in EMU 2011', p. 101.

**Figure 4 – Notification of national implementing measures per year**



Source: ECA.

**73** Since not all Member States had transposed Directive 2011/85 by the deadline, shortly thereafter, the Commission opened 17 infringement procedures for 'failure-to-notify' national implementing measures. As [Table 2](#) shows, the majority of these cases (14) were closed within 1 year, which is the Commission's benchmark<sup>52</sup>. Due to long law adoption processes in Slovenia and Czechia, these countries only finished transposing Directive 2011/85 in 2018 and 2019 respectively. This inevitably delayed the start of the compliance assessment process for all 17 Member States subject to infringement procedures.

<sup>52</sup> ECA (2018), Landscape review: 'Putting EU law into practice: The European Commission's oversight responsibilities under Article 17.1 of the Treaty on European Union', Box 4.

**Table 2 – State of play of the infringement procedures on non-communication (June 2019)**

Opening of infringement procedure for “failure to notify” 27 January 2014	BE, BG, CZ, DK, DE, EE, EL, HR, IT, CY, LT, LU, MT, AT, SI, FI, UK	
Closed in July 2014	BE, DK, DE, EE, HR, IT, CY, LT, AT, FI, UK	WITHIN BENCHMARK
Closed in November 2014	EL, LU, MT	
Closed in July 2015	BG	TWO MONTHS BEYOND BENCHMARK
Referral to the Court of Justice of the EU in July 2017	SI	LONG DELAYS
Ongoing	CZ	

Source: ECA.

**74** The Commission did not complete the compliance assessments, consisting of a transposition check and conformity check, within its own benchmark period<sup>53</sup> and the performance targets set in DG ECFIN’s Annual Management Plans for the 2014-2017 period were only partially achieved.

**75** As a result of its transposition and conformity checks, in August 2016, the Commission started EU ‘pilot procedures’ for 11 Member States, in April 2017 for another 7, and again in July 2019 for another 7 Member States. This was a first step to try to resolve transposition problems and thus avoid formal infringement proceedings, if possible. For the three remaining Member States, as of September 2019, the Commission had not yet decided whether to start ‘pilot procedures’.

**76** The sequencing of the EU ‘pilot procedures’ (see [Table 3](#)) was not dictated by an implementation plan but rather by operational reasons, i.e. by the availability of Member States to carry out the EU ‘pilot dialogues’ with the Commission in English for the first wave and by the Commission’s level of internal preparedness for the second and third waves. As a result, some euro-area Member States with high general

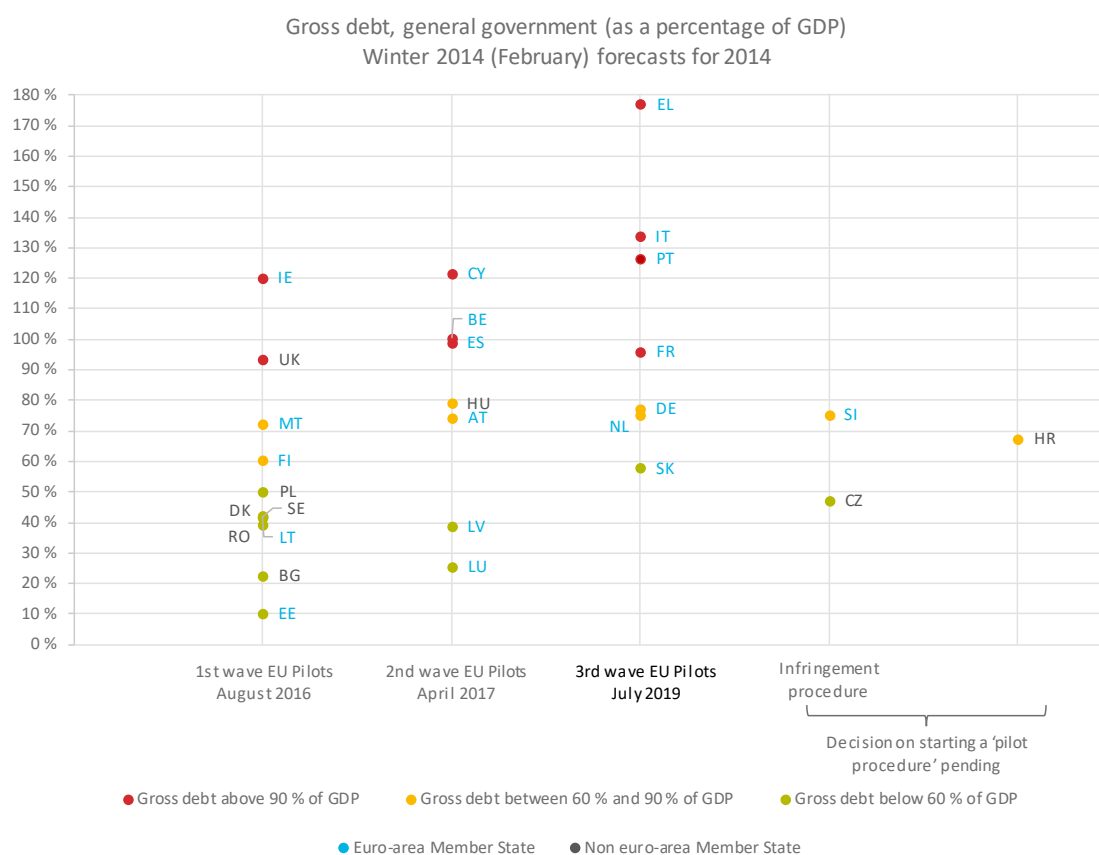
<sup>53</sup> Transposition checks should be finalised within 6 months of the transposition deadline or from the national implementing measure notification date and conformity checks within 16 to 24 months of the date of the communication of the national transposition measures.



government debt, i.e. those for which achieving a sound fiscal position is more important, were not assessed as a matter of priority (see [Figure 5](#)).

**77** In 2014 (by which time transposition by the Member States was supposed to have been completed), the seven euro-area Member States for which the Commission has started in 2019 a ‘pilot procedure’ (see [Figure 5](#), third column) accounted for 77 % of euro-area GDP (66 % of the combined GDP of all EU Member States excluding the United Kingdom and 56 % of the combined GDP of all EU Member States including the United Kingdom) and for 77 % of euro-area public debt (72 % of combined public debt of all EU Member States excluding the United Kingdom and 60 % of the combined public debt of all EU Member States including the United Kingdom).

**Figure 5 – Breakdown of the Member States by waves of EU pilots**



Source: ECA.

**78** The 18 EU pilot cases started under the first and second waves were closed with considerable delays, and lasted on average more than 65 weeks, well above the Commission’s 20-week benchmark. In 3 of the 18 cases, we noticed particularly large time gaps in communication (nearly a year, or more) where the Commission had been waiting for the Member States to implement the required measures. These three procedures were eventually closed within two years of being started. In one case, the

Commission rejected the replies of the Member State (Belgium). In total, the Commission closed eleven Member States' 'pilot procedures' with a positive compliance assessment. For another seven cases the Commission rejected the Member States' replies. By September 2019, four of those seven cases were closed. The Commission is continuing its informal exchanges with the other Member States (see [Table 3](#)) but has not yet started any infringement procedures<sup>54</sup>.

**Table 3 – Duration and status of EU pilots**

Member State	Opening date	Closure date	EU pilot duration (in weeks)	Closure status of EU pilot	Date of "classement"	Duration between "rejection and "classement" (in weeks)	Total Duration (in weeks)	
Bulgaria	01/08/2016	14/06/2017	45	Rejected answers	11/04/2019	95	140	
Denmark		10/04/2017	36	Accepted answers			36	
Estonia		01/09/2017	57	Rejected answers	08/11/2018	62	118	
Finland		29/05/2018	95	Accepted answers			95	
Ireland		02/03/2018	83	Accepted answers			83	
Lithuania		14/06/2017	45	Rejected answers	25/07/2019	110	155	
Malta		13/04/2018	89	Accepted answers			89	
Poland		14/06/2017	45	Rejected answers			165* + ?	
Romania		15/06/2017	45	Rejected answers			165* + ?	
Sweden		24/07/2017	51	Rejected answers	08/11/2018	67	118	
United Kingdom		06/04/2017	35	Accepted answers			35	
Austria	05/04/2017	20/07/2018	67	Accepted answers			67	
Belgium		18/03/2019	102	Rejected answers			130* + ?	
Cyprus		20/07/2018	67	Accepted answers			67	
Spain		26/03/2019	103	Accepted answers			103	
Hungary		06/12/2018	87	Accepted answers			87	
Luxembourg		20/07/2018	67	Accepted answers			67	
Latvia		13/03/2019	101	Accepted answers			101	
Germany		19/07/2019						
Greece								
France								
Italy								
Netherlands								
Portugal								
Slovakia								
Croatia	Decision on starting a 'pilot procedure' pending							
Slovenia								
Czechia								

\* Duration calculated until 30 September 2019.

Source: ECA.

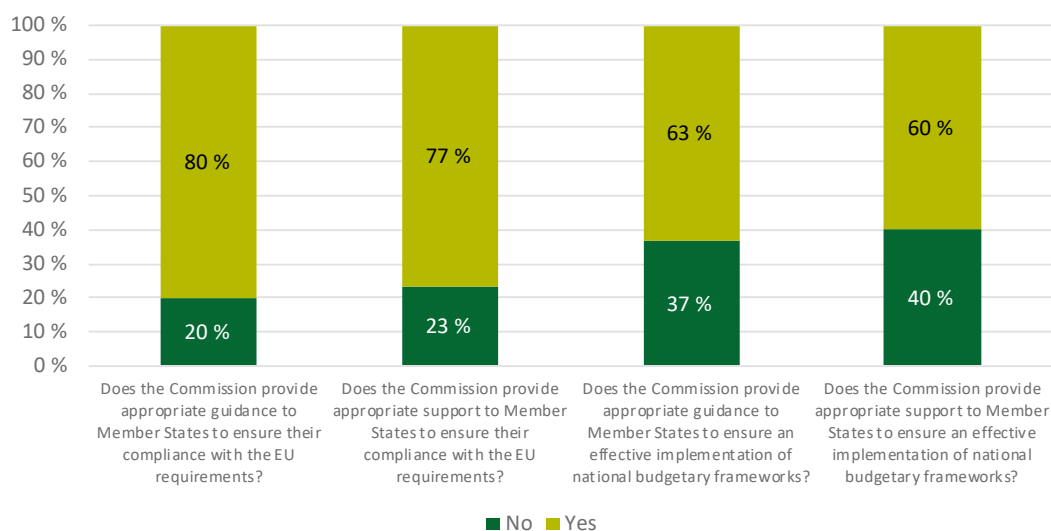
**79** The Commission had to start 17 'failure-to-notify' infringement procedures (see paragraph [73](#)) and Member States had to introduce an additional 102 national implementing measures as a result of the Commission's compliance checks during the 2015-2019 period (see [Figure 4](#)). This suggests, with the benefit of hindsight, that the Commission underestimated the challenges Member States faced in transposing Directive 2011/85 and did not take proactive measures to help them do so on time. In

<sup>54</sup> When an EU pilot has been used in a given case but is no longer likely to produce the expected results in a timely manner, the Commission should proceed with a formal infringement.

order to help Member States apply EU law correctly, the Commission often deploys an array of ‘compliance promoting tools’ at different stages in the policy cycle<sup>55</sup>. However, it did so to a limited extent in the case of Directive 2011/85.

**80** The Commission did provide guidance on NBFs to Member States: as well as the exchanges during the EU ‘pilot procedures’, there were also mostly informal exchanges (e.g. by emails, phone calls or bilateral meetings) with for example reviews of draft Member State legislation transposing Directive 2011/85. This was confirmed by the stakeholders we met, as well as our survey of IFIs (see [Figure 6](#)). It is noteworthy that the Commission provided less support and guidance to ensure effective application of the NBFs than it did to ensure Member States’ compliance with EU requirements.

**Figure 6 – Reply to the ECA survey on provision of guidance and support by the Commission**



Source: ECA survey.

<sup>55</sup> Implementation plans, guidelines, explanatory documents, networks, expert groups, workshops, package meetings, scoreboards serve as ‘compliance promoting tools’.

## Commission assessments to date are of limited informative value, either due to timing or mandate considerations

**81** We analysed the Commission's assessments pursuant to Directive 2011/85, the TSCG and Regulation 473/2013.

### Assessment of the application of Directive 2011/85

**82** After assessing compliance of the national transposing measures, the Commission is required to monitor and assess the application of Directive 2011/85.

**83** The Commission has not yet started assessing the application of Directive 2011/85 in a structured and systematic manner. It plans to do so<sup>56</sup> once it finishes assessing all Member States' transposition of the requirements of Directive 2011/85 into national legislation (see [Table 3](#)).

**84** As of October 2019, the Commission had not yet put in place a strategy setting out the methodology, criteria, milestones and deliverables from Member States, in order to ensure appropriate and timely monitoring of the application of Directive 2011/85.

**85** In some cases, despite implementing Directive 2011/85, Member States (for example Italy and Spain) do not show improvements in their fiscal performance in line with the requirements of the SGP. However, the Commission has not yet exercised its monitoring powers<sup>57</sup> by carrying out an assessment focused on the operational performance of key elements of the NBFs. Such an approach is used, for example, by the IMF in its Fiscal Transparency Evaluation.

**86** Alternatively, it may also use the Public Expenditure and Financial Accountability (PEFA) methodology. The Commission itself, through the Directorate-General for International Cooperation and Development (DG DEVCO), developed the PEFA methodology together with the IMF and the World Bank. Therefore, it would have, in-house, the knowledge needed to carry out PEFA assessments.

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<sup>56</sup> Some aspects of the application assessment were already included in the transposition assessment.

<sup>57</sup> European Commission (2012), 'Report on public finances in EMU 2011', p. 101.

**87** In addition to the assessment of compliance and application, Directive 2011/85 required the Commission to carry out a suitability review by mid-December 2018.

**88** The requirement to carry out a suitability review was not specifically included in the Commission's initial proposal, but was added in the course of the legislative process. Moreover, despite MTBFs being a central element of NBFs and of Directive 2011/85, the scope of the suitability review does not explicitly include them. However, we take note of the Commission's intention to include MTBFs in the scope of this review.

**89** Despite the December 2018 deadline, as of October 2019, the Commission had not yet published its suitability review of Directive 2011/85.

**90** However, based on an economic study, the Commission concluded in January 2019 that "national ownership of EU fiscal rules has been strengthened in recent years thanks to stronger national fiscal frameworks being created, following legislative initiatives put forward at the EU level"<sup>58</sup>. The study looked at econometric evidence showing a link between the MTBFs' quality (measured by the MTBF index, see paragraph 04) and the cyclically-adjusted primary balance. This strong link is interpreted as showing a positive effect on fiscal discipline, as a result of national ownership.

**91** The MTBF index assesses the quality of the NBFs on the basis of 11 criteria (see [Table 4](#)). One of the requirements of Directive 2011/85 is not covered by any criterion, and six of the criteria used do not correspond to requirements of Directive 2011/85 but to other features, which the Commission considers desirable.

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<sup>58</sup> European Commission (2019), 'Report on public finances in EMU 2018', p. 138.

**Table 4 – Comparison between Directive 2011/85 requirements on MTBFs and MTBF index criteria for both old and new (fine-tuned) methodology**

Directive 2011/85	2017 MTBF index: criteria	Max. Score per criterion on new index	Max. standardised score that can be allocated to criteria covered by Directive 2011/85
Article 9.2.(a)	C1a - Coverage of the targets/ceilings included in the national medium-term fiscal plans	3	0.2
Article 13	C1b - Co-ordination before setting the targets	1	
Article 10	C2a - National medium-term fiscal plans and annual budget: connectedness	4	0.13
✘	C2b - Fixed objectives/ceilings in medium-term plans that are fixed in advance	1	
✘	C2c - Well defined corrective actions in case of deviation from plans	1	
✘	C3 - National Parliament involved in national medium-term fiscal plans preparation	3	0
✘	C4 - IFI involved in national medium-term fiscal plans preparation	4	0
Article 9.2(b)	C5a - Breakdown of expenditure and revenue projections	1	0.1
✘	C5b - Explanation on revenue and expenditure projections and their components	1	
Article 9.2(c)	C5c - Quantification of the impact of reforms over the time span of the plan	1	
✘	C5d - Detailed explanations on the budgetary impact of the alternative macro scenarios	1	
Article 9.2(d) - estimate of impact of new policies on long term debt sustainability	✘	✘	✘
<b>Total potential score</b>			<b>1</b>
<b>Total potential score regarding criteria covered by Directive 2011/85</b>			<b>0.43</b>
<b>Percentage of score allocated based on criteria not covered by Directive 2011/85</b>			<b>57%</b>

Note: ✘ : not included.

Source: ECA.

**92** However, this analysis, while valuable, cannot be regarded as a review of the suitability of Directive 2011/85 concerning requirements on MTBFs, for the following reasons:

- the MTBF index used in this analysis is based on the Fiscal Governance Database (see paragraph 04), which is mainly fed with information provided by national authorities, rather than information from an autonomous assessment by the Commission of the functioning of the NBFs;
- the criteria used for scoring the index and Directive 2011/85 requirements are only partially overlapping (see paragraph 91);
- an improvement in the MTBF index may just reflect the enactment of a budgetary reform, even if it is not yet operational, i.e. the index may just capture the conformity of its design rather than its actual functioning (see Box 4);

- the MTBF index spans the period 2006-2015. However, 2015 predates the start of the EU ‘pilot procedures’, meaning that the index could not possibly reflect the Commission’s assessment of either the transposition or application of Directive 2011/85;
- the MTBF index shows an improvement (increase in the score) for euro-area Member States either in 2011 or earlier years with the exception of France, Germany, Finland (slight increases in 2012, 2013 and 2015 respectively) and Luxembourg (2014). However, improvements that occurred in 2011 and earlier years cannot be regarded as reflecting the impact of Directive 2011/85, which entered into force only on 13 December 2011. Member States under a financial assistance programme (Cyprus, Greece, Ireland, Latvia, Spain and Portugal) also saw improvements, as did a Member State in the process of joining the euro (Lithuania). However, the Commission’s analysis, while recognising the role played by financial assistance programmes, does not disentangle the impact of Directive 2011/85 from the impact of the obligations under the financial assistance programme or of the Member State’s drive to join the euro area.

#### **Box 4 – Examples of an increasing score of the MBTF index linked to the enactment and not the actual functioning of budgetary reforms**

We found that the Commission had upgraded the MTBF index of some of the Member States in our sample (Italy, Latvia and Luxembourg) immediately after they had enacted budgetary reforms (in 2009, 2013 and 2014 respectively), even though the application of these reforms (and hence their effect) was gradual and was not completed by 2015.

In the case of Italy, a new accounting law was passed in 2009, but several secondary legislative acts were needed and were approved over time. The implementation process is still ongoing (according to reports from the Ministry of Finance).

In the case of Luxembourg and Latvia, in the course of the EU ‘pilot procedures’, the Commission identified gaps between the enacted reform and the requirements of Directive 2011/85. These delayed the conclusion of the ‘pilot procedures’. National authorities had to fill those gaps through legislative or administrative amendments, which took place – and hence took effect – only after the cut-off date for the econometric analysis.

## Assessment of the Fiscal Compact

**93** The TSCG requires the Commission to present “in due time” a report assessing the compliance with the Fiscal Compact of the national provisions adopted by Member States (see paragraph 06). Based on information provided by the Member States, the Commission issued its report on 22 February 2017<sup>59</sup>. In line with its mandate, the Commission's assessment focuses on the legal compliance of the national provisions. It did not receive any mandate to assess the effective application of the new national rules transposing the Fiscal Compact.

**94** The main conclusions that can be drawn from the report are that:

- all Member States have put in place a binding balanced budget rule, although only some at a constitutional level;
- Member States differ in their definition of exceptional circumstances allowing a temporary deviation from their MTO;
- Member States differ in the extent to which the correction mechanism is automatic and in the scope of the required corrective action;
- legal provisions were adopted in all Member States to set up IFIs although the Commission had some concerns regarding the independence safeguards of some of them;
- many Member States had not yet integrated the ‘comply-or-explain’ principle into their legal framework (i.e. a government has to justify when it does not comply with the assessments of the IFI), but they committed to apply it appropriately.

**95** The Commission’s overall assessment was positive, even though the transposition of the Fiscal Compact was slow and incomplete. In fact, the Commission’s positive assessment of 16 Member States’ compliance was conditional upon their implementation of commitments they had made. As pointed out by the ECB<sup>60</sup>, however, commitments are “not an adequate substitute for legal provisions, as they

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<sup>59</sup> European Commission (2017), C(2017) 1201 final, ‘Report from the Commission presented under Article 8 of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union’.

<sup>60</sup> ECB (2017), ‘Economic Bulletin 4’, Box 8: The fiscal compact: the Commission’s review and the way forward.



are not enforceable". The Commission's assessment was thus not complete and, by accepting commitments, it weakened the requirements.

### Assessment of the implementation of Regulation 473/2013

**96** The Commission in November 2014 carried out a first assessment of the application of Regulation 473/2013, in the context of the review of the economic governance covering the Six-Pack and Two-Pack legislative acts. However, the assessment was inconclusive, as it came too soon after the entry into force of Regulation 473/2013. The next assessment is due by the end of 2019.

**97** The Commission also monitors developments of national legislation on NBFs and their application through the European Semester<sup>61</sup>, albeit to a limited extent: it assesses whether the Member States' budget positions are approaching their MTOs (see paragraph 46), but does not evaluate in detail the functioning of the underlying NBFs. *Figure 7* provides further details on the various steps.

### Figure 7 – the Commission's assessment of the NBFs at the different steps of the European Semester



Source: ECA.

<sup>61</sup> The annual EU cycle of economic policy coordination also covering fiscal policies as determined by the SGP.

## Conclusions and recommendations

**98** We looked at whether the Commission's actions to strengthen the budgetary frameworks of the EU Member States achieved the results intended. We conclude that by proposing Directive 2011/85 and Regulation 437/2013, which have been adopted, and the 2017 draft Directive, for which the legislative process is still ongoing, the Commission contributed to fostering improvements in national budgetary frameworks (paragraph 17).

**99** However, the Commission has not clarified how it will minimise possible divergences between the independent fiscal institutions' and the Commission's assessments of compliance with EU fiscal rules in cases where both the Commission and national independent fiscal institutions assess the compliance with EU fiscal rules.

**100** There have been instances where the Commission and an independent fiscal institution have come to different conclusions. One reason for this is that, in assessing compliance, the Commission makes full use of the discretion granted to it by EU law, and its power to interpret this discretion. This applies particularly to the "exceptional circumstances" accepted as justification for softening the adjustment requirements for Member States that have not yet reached their medium-term budgetary objectives (paragraphs 45 to 55).

### Recommendation 1 – Compliance assessments by the Commission and the independent fiscal institutions

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To ensure that independent fiscal institutions can fulfil their role effectively, and in order to minimise divergence between the independent fiscal institutions' and the Commission's assessments of compliance with EU fiscal rules, the Commission should strengthen cooperation with the independent fiscal institutions.

**Timeframe: 2020 onwards.**

**101** A number of requirements in the EU legal framework concerning medium-term budgetary frameworks and independent fiscal institutions fall short of the international standards and best practice set by the IMF and the OECD, and often despite the views expressed in economic papers published by the Commission itself. The 2017 draft Directive, if approved, would only partially correct those weaknesses (paragraphs 18 to 41).

## Recommendation 2 – Review requirements for national budgetary frameworks

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To further strengthen budgetary frameworks, the Commission should review the requirements for medium-term budgetary frameworks and independent fiscal institutions, also taking into account international standards and best practice, and propose actions as appropriate to improve their scope and effectiveness. The Commission should base this on the observations made in this report, as well as on the results of its suitability review and its assessment of the compliance and application of Directive 2011/85 and Regulation 473/2013.

**Timeframe: within one year of the publication of the Commission’s assessment of the Six- and Two-Packs (which include Directive 2011/85 and Regulation 473/2013).**

**102** The effectiveness of the European Fiscal Board is limited by its current institutional set-up. Moreover, the ‘comply-or-explain’ principle does not apply to the Commission (paragraphs 56 to 68).

## Recommendation 3 – Strengthen the European Fiscal Board

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To further strengthen enforcement of the EU fiscal rules and independent assessment of the Commission’s work with respect to the national dimension, the Commission should:

- (a) review the mandate as well as the institutional set-up of the European Fiscal Board and publish Commission’s conclusions, including justifications in case no changes will be proposed;
- (b) apply the “comply-or-explain” principle whereby the Commission should publicly justify instances when it does not comply with assessments of the European Fiscal Board.

**Timeframe: within one year of the publication of the Commission’s assessment of the Six- and Two-Packs (which include Directive 2011/85 and Regulation 473/2013).**

**103** The Commission has not yet completed its assessment of the compliance of national legislation with the requirements of Directive 2011/85, which included transposition and conformity checks (paragraphs 72 to 80).

**104** The Commission's assessments on the application of the EU legal framework (Directive 2011/85 and Regulation 473/2013) have either not yet been carried out or came at too early a stage of implementation to be meaningful (paragraphs 84 to 92 and 96).

**105** The Commission's current monitoring of the developments on national budgetary frameworks is, amongst other things, based on the Fiscal Governance Database. It is fed with information provided by the Member States, which mainly focuses on institutional set-up rather than on actual functioning (paragraph 92).

## **Recommendation 4 – Strengthen enforcement of national budgetary frameworks**

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To assess whether the objectives set in the legal acts (Directive 2011/85 and Regulation 473/2013) were achieved, and considering that eight to six years have passed since their adoption, the Commission should:

- (a) finalise without further delay the compliance assessment;
- (b) carry out and publish as soon as possible a comprehensive suitability review of Directive 2011/85;
- (c) revise the Fiscal Governance Database questionnaires or identify another suitable tool to request on a regular basis comprehensive information on the actual functioning of the national budgetary frameworks;
- (d) on a regular basis, monitor the functioning of the national budgetary frameworks, through a structured methodology focusing on the operational performance of key elements of the national budgetary frameworks. The Commission should follow up any significant weakness identified.

**Timeframe for (a): by mid-2020, (b): by end-2019, (c): by end-2020, and (d): 2021 onwards.**

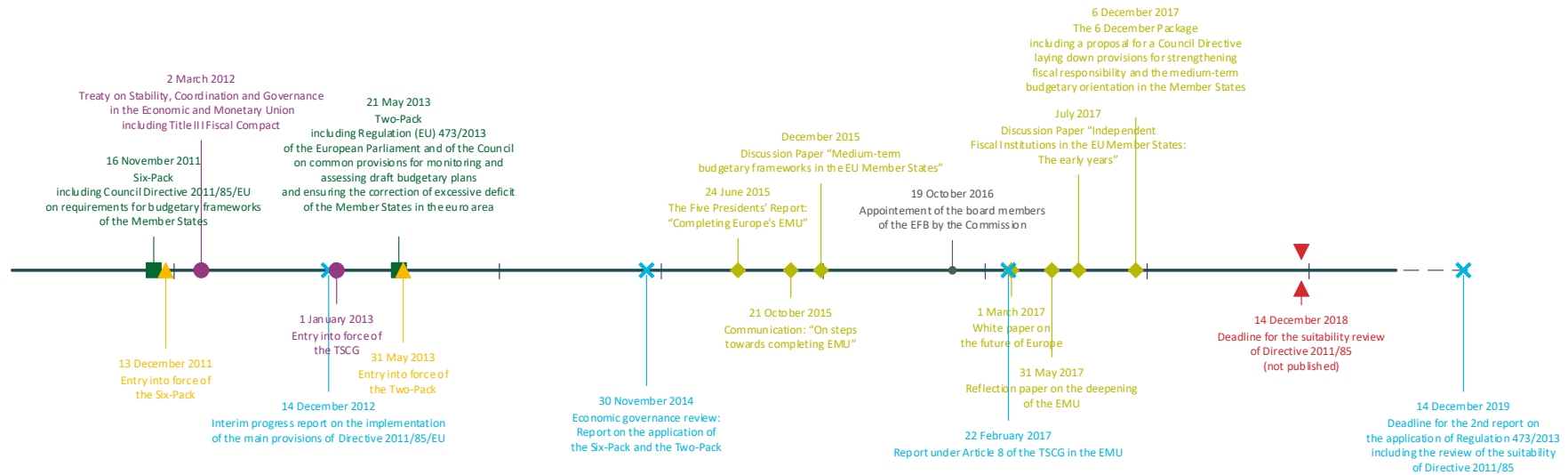
This Report was adopted by Chamber IV, headed by Mr Brenninkmeijer, Member of the Court of Auditors, in Luxembourg on 15 October 2019.

*For the Court of Auditors*

Klaus-Heiner Lehne  
*President*

# Annexes

## Annex I – Timeline of relevant legal basis and publications



**Legend**

- Treaties and Secondary legislations
- Entry into force of Treaties and Secondary legislations
- Reports/Papers from the Commission
- Intergovernmental Treaty and its entry into force
- Reviews carried out or planned
- Appointment of members
- Suitability review not published

Source: ECA.

## Annex II – Commission’s view on the medium-term budgetary framework

*(i) A single process for preparing MTBF and annual budget, and fully integrated documentation.*

**01** The Commission had acknowledged already in 2011 the problem that “while Stability and Convergence Programmes (SCPs) are already presented from a multi-annual perspective, these policy documents have remained of limited policy relevance in the domestic debate surrounding the discussion of budgetary strategies, despite the fact that Member States are supposed to draft their budget in accordance with their SCP commitments”<sup>62</sup>. Also in its 2012 interim progress report on the implementation of Directive 2011/85 the Commission referred to the integration of MTBF within the annual budget cycle, as well as to fully integrated documentation as key features “to be carefully considered”<sup>63</sup>.

*(ii) Forward-looking expenditure controls that ensure compliance with the medium-term plans.*

**02** With regard to carryover arrangements the Commission pointed out the need to set limits to unspent appropriations that can be carried over in the next budget year(s), otherwise “such arrangements may somewhat diminish the stringency and predictive power of the framework”<sup>64</sup>. Furthermore, the Commission regards “defining appropriate contingency reserves and related access rules” as a necessary feature for a multi-annual framework<sup>65</sup>.

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<sup>62</sup> European Commission (2012), ‘Report on public finances in EMU 2011’, p. 105.

<sup>63</sup> European Commission (2012), COM(2012) 761 final, ‘Report from the Commission to the European Parliament and the Council, Interim Progress Report on the implementation of Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States’, p. 6.

<sup>64</sup> European Commission (2015), Sherwood, M., ‘Medium-Term Budgetary Frameworks in the Member States’, discussion paper 021, p. 6.

<sup>65</sup> European Commission (2012), ‘Fiscal frameworks in the European Union: May 2012 update on priority countries (Addendum to occasional paper 91)’, occasional paper 113, p. 15.

(iii) *Accountability mechanism*<sup>66</sup>.

**03** It is noted also that lack of provisions concerning the monitoring of multi-annual budgetary implementation is not consistent with the Commission's position on key requirements for MTBFs. Indeed, since 2006 the Commission's methodology for the calculation of the MTBF index considers "monitoring and enforcement of multiannual budgetary targets" one of the five dimensions for assessing the quality of MTBF in the Member States<sup>67</sup>. Moreover, the Commission acknowledged already back in 2007 that lack of monitoring is a weakness across Member States<sup>68</sup>. Furthermore, the Commission reiterated in 2010 that analysis of departures from the envisaged fiscal path, as well as monitoring and corrective mechanisms are key elements in the design of MTBFs<sup>69</sup>.

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<sup>66</sup> IMF (2010), Lienert, I. and Fainboim, I., 'Reforming Budget Systems Laws', Box 3 and Box 4.

<sup>67</sup> European Commission (2007), 'Report on public finances in EMU 2007', Box III.4.1; European Commission (2015), Sherwood, M., 'Medium-Term Budgetary Frameworks in the Member States', discussion paper 021, Box A1.1.

<sup>68</sup> European Commission (2007), 'Report on public finances in EMU 2007', p. 158.

<sup>69</sup> European Commission (2010), 'Report on public finances in EMU 2010', Box II.3.3.



## Annex III – Heterogeneity of independent fiscal institutions

		Members of the Board				Human resources		Set-up of the IFI	Budget of the IFI		External review
		Number	Length of the term (years)	Renewable term		Number (FTE*)	Management have full freedom to hire and dismiss staff	Stand-alone or attached	Source	Amount in 2017 (million EUR)	
France	High Council of Public Finances	11	5	YES	Once	3/4	YES	Attached to the National Audit Office	Sub-program in the National Audit Office's budget	0.8	n/a
Greece	Hellenic Fiscal Council	5	4/6	YES	Once	13	NO	Stand-alone	Quarterly transfers from the State Budget	1.1	Technical evaluation every 4 years
Italy	Parliamentary Budget Office (UPB)	3	6	NO	n/a	24	YES	Attached to the Parliament	Funding equally provided by the two Houses of Parliament	6	n/a
Latvia	Fiscal Discipline Council	6	6	YES	Twice	2	NO	Stand-alone	Sub-programme in the Ministry of Finance's budget	0.19	n/a
Luxembourg	National Council of Public Finance	7	4	YES	No limit specified	2	NO	Attached to the Ministry of Finance	Sub-program in the Ministry of Finance's budget	0.1	n/a
	National Institute of statistics and economic studies (STATEC)	n/a	n/a	n/a	n/a	160	YES	Attached to the Ministry of Economy	Sub-program in the Ministry of Economy's budget	22.7	n/a
Netherlands	Netherlands Bureau for Economic Policy Analysis (CPB)	3	7	NO	n/a	117	YES	Attached to the Ministry of Economic Affairs	80 % lump-sum funding from Ministry of Economic Affairs 20 % project-based funding from Ministries	15.4	Peer review by academics and by clients about every 5 years
	Advisory Division of the Council of State	22	Life	n/a	n/a	3	YES	Attached to the Council of State	Own chapter in the State Budget	0.32	n/a
Portugal	Public Finance Council (CFP)	5	7	NO YES for non-executive members	n/a Once	18	YES	Stand-alone	Annual transfer from the State Budget	2.6	OECD review conducted in 2019
Spain	Independent Authority for Fiscal Responsibility (AiReF)	4	6	NO	n/a	35	YES	Attached to Ministry of Finance	Budget from State General Budget Law + fee charged to public entities for the AiReF supervision.	5.07	OECD review conducted in 2017

\* FTE: Full-time equivalent.

Source: ECA based on Commission's data.

## Annex IV – The fiscal rules in the preventive arm of the Stability and Growth Pact and in the Fiscal Compact

	Preventive arm of the Stability and Growth Pact	Fiscal Compact
<b>Objective</b>	Requirement of a close to balance or in surplus budgetary position, meaning a structural balance at or above the MTO	The budgetary position of the general government of a contracting party shall be balanced or in surplus (i.e. structural balance $\geq$ MTO)
<b>Specification</b>	<p>Country specific MTO with a limit of -1 % of GDP for euro-area Member States</p> <p>Expenditure benchmark: expenditure net of discretionary measures should grow <math>\leq</math> medium-term potential GDP</p>	Country specific MTO, as defined in the SGP, with a limit of -0.5 % of GDP for euro-area Member States (or -1 % if the Debt-to-GDP ratio "is significantly below 60 % and where risks in terms of long-term sustainability of public finances are low")
<b>Adjustment path</b>	<p>0.5 % of GDP as a benchmark (more in good times, less in bad times)</p> <p>Possible temporary deviations from the MTO or the adjustment path towards it in case of:</p> <ul style="list-style-type: none"> <li>— Implementation of major structural reforms which have a verifiable impact on the long-term sustainability of public finances – emphasis on pension reform</li> <li>— Unusual event outside the control of the Member State concerned which has a major impact on its financial position</li> </ul>	<p>The contracting parties shall ensure rapid convergence towards their respective MTO. The timeframe for such convergence will be proposed by the Commission taking into consideration country-specific sustainability risks.</p> <p>The contracting parties may temporarily deviate from their respective MTO or the adjustment path towards it only in "exceptional circumstances".</p> <ul style="list-style-type: none"> <li>— Unusual event outside the control of the contracting party concerned which has a major impact on the financial position of the general government</li> </ul>

	Preventive arm of the Stability and Growth Pact	Fiscal Compact
	<ul style="list-style-type: none"> <li>— Periods of severe economic downturn for the euro area or the Union as a whole provided this does not endanger fiscal sustainability in the medium term</li> </ul>	<ul style="list-style-type: none"> <li>— Periods of severe economic downturn as set out in the revised SGP, provided that the temporary deviation of the contracting party concerned does not endanger fiscal sustainability in the medium-term.</li> </ul>
<b>Enforcement specification</b>	Procedure for correcting significant deviation	An automatic correction mechanism (on the basis of common principles to be proposed by the Commission)
<b>Overall assessment</b>	<p>Vade Mecum on the SGP (2018 Edition, p. 23):</p> <p>“compliance with the requirements of the preventive arm is assessed using a two-pillar approach. The assessment of the structural balance, which constitutes one pillar, is complemented by an analysis of the growth rate of an expenditure aggregate net of discretionary revenue measures, which constitutes the other pillar.”</p>	<p>TSCG, Article 3.1(b)</p> <p>“Progress towards, and respect of, the medium-term objective shall be evaluated on the basis of an overall assessment with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures, in line with the revised Stability and Growth Pact.”</p>

# Acronyms and abbreviations

**Council:** Council of the EU

**CSR:** Country-specific recommendation

**DG ECFIN:** Commission Directorate-General for Economic and Financial Affairs

**ECB:** European Central Bank

**Ecofin Council:** Economic and Financial Affairs Council

**EFB:** European Fiscal Board

**GDP:** Gross Domestic Product

**IFI:** Independent fiscal institutions

**IMF:** International Monetary Fund

**MTBF:** Medium-term budgetary framework

**MTO:** Medium-term budgetary objective

**NBF:** National budgetary framework

**OECD:** Organisation for Economic Co-operation and Development

**PEFA:** Public Expenditure and Financial Accountability

**SGP:** Stability and Growth Pact

**TFEU:** Treaty on the Functioning of the European Union

**TSCG:** Treaty on Stability, Coordination and Governance in the Economic and Monetary Union

# Glossary

**Application:** The action of bringing EU and national laws into force.

**Automatic correction mechanism:** An obligation to implement corrective measures that is automatically triggered in the event of significant observed deviations from the medium-term budgetary objective or the adjustment path towards it.

**Balanced budget rule:** The budgetary position of the general government must be balanced or in surplus. In both the Stability and Growth Pact and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, this rule is deemed to be complied with if the annual structural balance of the general government is at its medium-term budgetary objective.

**Compliance assessment:** An evaluation of transposition and conformity of the implementation at national level of an EU directive.

**Conformity check:** An initial verification of whether all the necessary directive provisions have been covered by the national implementing measures.

**Corrective arm of the Stability and Growth Pact:** The excessive deficit procedure started by the Council upon recommendation by the Commission against any EU Member State that exceeds the budgetary deficit ceiling imposed by the EU's Stability and Growth Pact Regulation. The procedure entails several steps, potentially culminating in sanctions, to encourage a Member State to get its budget deficit under control, and is a requirement for the smooth functioning of Economic and Monetary Union.

**European Fiscal Board (EFB):** An advisory body to the Commission that is responsible for evaluating the implementation of EU fiscal rules, proposing changes to the fiscal framework and performing economic assessments.

**Draft budgetary plan:** A document that euro-area governments have to submit annually to the Commission to serve as a basis for fiscal policy coordination.

**Economic Policy Committee (EPC):** An advisory body to the Ecofin Council and the Commission that helps foster consensus on economic policy (including jobs and growth) and the sustainability of public finances.

**European Semester:** The annual cycle that provides a framework for the coordination of the economic policies of EU Member States and for monitoring progress, in particular fiscal policies as determined by the Stability and Growth Pact.

**EU Network of IFIs:** A Commission-facilitated group set up in 2013, of EU national independent fiscal institutions and the European Fiscal Board, chaired by the Commission.

**EU 'pilot procedure':** An informal dialogue between the Commission and a Member State on potential non-compliance with EU law, prior to the start of a formal infringement procedure.

**Expenditure rule:** A long-lasting limit on absolute spending or on the spending growth rate.

**Fiscal Compact:** An agreement to strengthen budgetary discipline entered into by 22 contracting parties, out of the 25 that signed the intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

**Fiscal Governance Database:** A Commission tool containing information on the main elements of Member States' fiscal governance frameworks, namely national fiscal rules, independent fiscal institutions and medium-term budgetary frameworks.

**Fiscal performance:** The maintenance of budgetary discipline to foster macroeconomic stability and sustainable growth.

**Fiscal rule:** A permanent constraint on fiscal policy, often expressed as a numerical ceiling or target in proportion to gross domestic product on a fiscal performance indicator.

**Independent fiscal institution (IFI):** A public body, which promotes sound fiscal policy and sustainable public finances through performing a variety of tasks, including macroeconomic and budgetary forecasting and fiscal compliance assessments.

**Macroeconomic imbalance procedure (MIP):** The macroeconomic imbalance procedure aims to identify, prevent and address the emergence of potentially harmful macroeconomic imbalances that could adversely affect economic stability in a particular Member State, the euro area, or the EU as a whole.

**Medium-term budgetary framework (MTBF):** Fiscal arrangements extending the horizon for fiscal policymaking beyond the annual budgetary calendar.

**Medium-term budgetary objective (MTO):** A country-specific fiscal policy target set in the Stability and Growth Pact, which is for most Member States - 1 % of Gross Domestic Product and for euro-area Member States somewhat tighter, - 0.5 % of Gross Domestic Product, unless they have a low debt ratio.

**National budgetary framework:** Arrangements, procedures, rules and institutions underlying budgetary policies.

**Network of EU IFIs:** A platform established in 2015 for an exchange of views and expertise, as well as for pooling resources. Open to all independent fiscal oversight bodies operating in the EU, chaired by one of the IFIs.

**Potential output:** A theoretical concept of the level of output (Gross Domestic Product) in at a given moment that is consistent with stable inflation. It grows in time at a rate that is not necessarily constant. Both the level and the growth rate cannot be measured directly, but have to be estimated.

**Preventive arm of the Stability and Growth Pact:** The main objective of the preventive arm, as set in Council Regulation 1466/97 was to ensure that Member States rapidly converged towards a close-to-balance or surplus budget position, which would then allow them to deal with normal cyclical fluctuations without breaching the 3 % limit on headline deficit.

**Primary balance:** The budget balance net of interest payments on general government debt.

**Six-Pack:** An EU economic governance package of six legislative measures (five Regulations and Directive 2011/85) adopted in November 2011.

**Stability and convergence programmes:** Under the Stability and Growth Pact, Member States are obliged to submit a document annually setting out their fiscal plans for the next three years. Used by the Commission and finance ministers to assess whether countries are on track to reach their medium-term budgetary objective. Euro-area countries submit “stability programmes”, while Member States that have not adopted the euro produce “convergence programmes”.

**Stability and Growth Pact (SGP):** A set of rules adopted in 1997 designed to safeguard stability in the economic and monetary union by ensuring that Member States pursue sound public finances and coordinate their fiscal policies.

**Structural balance:** The actual budget balance net of the cyclical component and one-off and other temporary measures. The structural balance gives a measure of the underlying trend in the budget balance.

**Treaty on Stability, Coordination and Governance in the Economic and Monetary Union:** An intergovernmental treaty, adopted in 2012, which lays down rules fostering budgetary discipline and economic policy coordination among contracting parties, and improving governance of the euro area.

**Transposition:** Adoption, publication and entry into force of national provisions in application of an EU directive by the deadline set.

**Transposition check:** An assessment of the accuracy/compatibility of national implementing measures with the directive's provisions.

**Two-Pack:** An EU package of two legislative measures (Regulations 472 and 473) adopted in May 2013, aimed at strengthening economic governance in the euro area.



**REPLIES OF THE COMMISSION TO THE SPECIAL REPORT OF THE EUROPEAN  
COURT OF AUDITORS**

**“SPECIAL REPORT XX/2019 ON THE EU REQUIREMENTS FOR NATIONAL  
BUDGETARY FRAMEWORKS:  
NEED TO FURTHER STRENGTHEN THEM AND TO BETTER MONITOR THEIR  
APPLICATION”**

**EXECUTIVE SUMMARY**

I The Commission welcomes the ECA performance audit on fiscal stability. The Commission has been at the forefront of Union’s efforts to improve fiscal governance both at EU and Member States’ level. Leveraging its extensive knowledge on the topic of national budgetary frameworks (NBFs), the Commission put forward during the economic crisis legislative proposals introducing key requirements for the Member States’ fiscal frameworks, which were meant to improve the management of domestic public finances and to promote compliance with the EU fiscal rules. However, it should be noted that the Commission’s proposals were developed in a short period of time, under the pressure of the crisis, and were adopted by the co-legislators after protracted discussions and negotiations. The Commission’s subsequent actions focused on the implementation of the agreed framework and should therefore be assessed in this light.

II The perimeter of EU requirements for NBFs extends beyond the areas of independent fiscal institutions, fiscal rules and medium-term budgetary frameworks. Notably, important requirements are laid down in relation to forecasting for budgetary purposes, fiscal statistics and accounting, transparency of public finances and a common budgetary timeline for the euro area Member States.

III While the Commission is the institutional addressee of the performance audit, the Member States’ role and contribution need to be properly acknowledged. Firstly, the Member States agreed the set of requirements on NBFs which are enshrined in the relevant EU law and, in an intergovernmental setting, signed up to the intergovernmental Treaty on Stability, Coordination and Governance (TSCG) and its Fiscal Compact. Secondly, it is the Member States’ responsibility to transpose and apply the supranational requirements on NBFs. The way in which Member States implement the requirements has been a decisive factor for the effectiveness of the agreed framework.

The Commission is fully committed to further supporting the strengthening of NBFs across the EU, within the scope of powers conferred upon it by the Treaties. To this end, the Commission will give due consideration to the findings of the audit and will build on the lessons learnt from how the reinforced budgetary frameworks of the Member States have been performing as well as on relevant international practices.

IV The current legal provisions introduced a wide range of basic requirements across the main planks of Member States’ fiscal frameworks. The basic requirements for medium-term budgetary frameworks (MTBFs) and the establishing criteria for independent fiscal institutions (IFIs) are largely consistent with the relevant literature and international practices; in fact, in some respects the Union is a standard-setter. Notwithstanding this, the Commission does not wish to claim that there is no room to improve EU requirements for NBFs (as attested by its 2017 Directive proposal) or the way in which they are applied by the Member States.

The Commission recalls that the 2017 draft Directive aims to incorporate the substance of the TSCG into EU law. Its scope is therefore confined to those features of NBFs which the Commission deemed relevant for the incorporation.

V Differences may indeed arise between IFIs' and the Commission's assessments of compliance, for various reasons. Whereas the discretion given to the Commission by the legal texts that underlie the Stability and Growth Pact (SGP) can contribute to such differences, the Commission stresses that it undertakes its assessment of Member States' compliance with EU fiscal rules in a rigorous and transparent way and making appropriate use of the flexibility existing within the rules, in line with the commonly agreed position endorsed by the Council in February 2016.

The Commission considers that the risk of inconsistencies can and should be mitigated or handled efficiently. Regular exchanges and sharing of information between the Commission and the IFIs - as already undertaken by the Commission - are among the most effective risk mitigation measures.

VI The European Fiscal Board (EFB) was envisaged from the outset (i.e. the Five Presidents' Report) as a body to provide independent advice on the EU fiscal governance framework. Its statutory basis (i.e. Commission Decision (EU) 2015/1937) confirms this rationale by setting out the Board's mission as follows: "*The Board shall contribute in an advisory capacity to the exercise of the Commission's functions in the multilateral fiscal surveillance as set out in Articles 121, 126 and 136 TFEU as far as the euro area is concerned.*" This is further operationalised into a broad range of tasks and responsibilities. Accordingly, the EFB's statutory regime and its resource allocation were designed to ensure that the Board is fully capable of achieving its mission of providing independent assessment and advice.

The Commission takes into account all available elements which are deemed useful for its informed decision-making. This includes the inputs provided by the advisory EFB, where appropriate. However, as far as the application of a 'comply-or-explain' principle is concerned, a strict parallel between the EFB and the national independent fiscal councils cannot be drawn.

VII The Commission has been conducting thorough checks on the transposition of Directive 2011/85, to ensure that the respective requirements are properly embedded into the Member States' budgetary frameworks. As the conformity checks are virtually completed for two-thirds of the Member States and ongoing for the remainder, increased attention will be given to monitoring the implementation of the Directive's requirements by the Member States.

More generally, the Commission is also monitoring closely NBF developments via other regular processes such as the European Semester, peer reviews in the ECOFIN preparatory committees, annual updates of the Fiscal Governance Database, etc.

As regards the assessments mandated by the EU legal framework, the Commission underlines that there are specific review clauses in the Directive 2011/85 and Regulation 473/2013. The review of the Six- and Two-pack will provide an opportunity to take an in-depth and holistic look at what the various requirements on NBFs have delivered so far.

VIII Please see the Commission replies to the recommendations.

## **INTRODUCTION**

01 The Commission notes that the ECOFIN Council stated already in March 2005 that NBFs should support the objectives of the SGP and complement the EU fiscal framework (see the 'Ecofin Council report to the European Council of 22-23 March 2005 on improving the implementation of the Stability and Growth Pact'). In May 2010, the Council adopted Conclusions on Domestic Fiscal Frameworks, where it stressed the importance of resilient and effective fiscal frameworks for the implementation of the SGP and the sustainability of public finances. Those envisaged benefits motivated the Commission's choice to include in the Six-Pack a draft directive laying down requirements for NBFs.

02 With the benefit of its own analytical work, the Commission subscribes unequivocally to the broad consensus on the importance of having in place strong NBFs to enable sound fiscal performance.

03 While an all-encompassing analysis as referred to in paragraph 3 was not prepared, various facets of the EU and national fiscal frameworks were examined at length in different documents (most notably in the annual Report on Public Finances in EMU). The Commission conducted over time - including before the crisis - analytical work confirming the relevance of the two-tier approach to fiscal governance (i.e. at EU and national level) in support of meeting EU budgetary obligations of the Member States. That work also highlighted the challenges in the implementation of SGP as it stood at the time and the main weaknesses in the NBFs based on the information collected through the Fiscal Governance Database.

**Box 2 - Concepts explained** Concerning the automatic correction mechanism, the Commission underlines that this is an obligation stemming from the TSCG.

08 Apart from the TSCG-related provisions, Regulation 473/2013 includes other important requirements for NBFs, notably the independent production/endorsement of the macroeconomic forecasts underpinning annual budgets and national medium-term fiscal planning, and a common budgetary timeline for (i) presenting and adopting draft annual budgets and (ii) presenting national medium-term fiscal plans.

09 The proposal of the Commission responded to the incorporation will expressed by the TSCG Contracting Parties (as enshrined in Article 16 TSCG) and to the calls of the European Parliament for integration into the Union framework.

## **OBSERVATIONS**

18 The current set of supranational NBF requirements was developed gradually, alongside the unfolding of the crisis, and had to come in the form of various legal instruments for objective reasons. Most notably, given the particular fiscal challenges posed by the crisis, the euro area Member States acknowledged the need to adopt specific measures going beyond the provisions applicable to all Member States, including with respect to NBFs.

19 Second indent: The Commission does not consider that NBFs' features should be prescribed extensively at supranational level. The Commission draws attention to its Report on Public Finances in EMU 2011 (p. 101), which argued that going beyond minimum requirements in the Directive 2011/85 would not have been compatible with the considerable differences across Member States' administrative and institutional structures. The choice of minimum requirements sought to apply the lessons learnt from features that are conducive to good policymaking while allowing Member States the discretion of applying them in an appropriate way.

The legislative instruments that introduced supranational NBF requirements were developed sequentially and the choice of legal vehicle - specifically, directive or regulation with a different degree of prescriptiveness - was based on content and purpose considerations relevant at the time of drafting.

The Commission considers that the heterogeneity of NBFs should be seen as a way to accommodate the fundamental aim to increase national ownership.

21 The 2017 draft Directive has indeed a wider scope. Beside a medium-term objective in terms of structural balance, the envisaged framework would include: (i) setting a medium-term growth path of net government expenditure consistent with that medium-term objective and fixed for the whole term of the legislature, (ii) laying down the obligation for annual budgets to respect the medium-term growth path of net expenditure, (iii) having a correction mechanism to deal with deviations over the

medium-term. The draft Directive also proposes an extensive involvement of IFIs in fiscal policy making and monitoring of budgetary developments.

While an explicit numerical constraint is not specified for the medium-term objective, the draft Directive states that the framework of numerical rules should effectively promote compliance with the TFEU budgetary obligations, i.e. including compliance with the MTO as provided for in the SGP. More generally, the absence of an explicit numerical constraint for the medium-term objective could be considered as being outweighed by the draft Directive's approach of establishing stronger foundations of fiscal discipline through binding medium-term expenditure path and stronger role of IFIs.

22 The Commission acknowledges that the draft Directive departs from the *ad litteram* reading of the Fiscal Compact, as it proposes different – better, in the Commission's view – instruments to reach the same objectives. However, the Commission does not agree with the quoted opinion of the ECB that the provisions of the draft Directive may lead to weakening of the rules of the Fiscal Compact.

As to the timing of the proposal, the Commission would like to recall the timeframe set out by Art. 16 TSCG for the Contracting Parties to take steps to incorporate the substance of the Treaty into EU law, which is "*within five years at most following the entry into force*". By putting forward the proposal in December 2017, which was well before the review of the Six and Two-pack legislation, the Commission sought to allow the Contracting Parties to fulfil their commitment to integrate the Fiscal Compact into EU law (which is also in line with the longstanding Commission position).

27 As the common principles were adopted after the Commission's proposal for Regulation 473/2013, adding new and substantive provisions on national correction mechanisms (of which there was no mention in the original draft Regulation) would have amounted to a significant alteration of the Commission proposal. The Commission believes that such alteration would have had negative repercussions on the adoption of the Regulation.

To address the issue, the Commission proposed to bring key features of the correction mechanisms into the fold of EU law at the first regulatory opportunity after the issuance of the common principles, namely via the 2017 draft Directive.

28 The 2017 draft Directive sets out key features of correction mechanisms based on the elements envisaged by the common principles – see Articles 3(2)(b), 3(3), 3(4)(c), 5 and 6. In some respects, the draft Directive actually goes somewhat beyond those elements, e.g. by (i) indicating that the correction mechanism should in particular compensate for deviations from the medium-term government expenditure path, or (ii) establishing the IFIs' obligation to call upon the budgetary authorities to activate the correction mechanism.

29 The Commission acknowledges that the draft Directive does not include a definition of the term "significant observed deviation". While the default understanding is that the term used in the draft Directive could be or could follow closely the concept as currently defined in the Stability and Growth Pact regulations, it could also possibly deviate from that concept.

In the Commission's view, the wording of the provision about the nature and size of deviation is appropriate for a Directive.

30 Common reply to paragraph 30 and Table 1:

The Commission follows closely existing and ongoing analysis on MTBFs and is itself conducting research in this area. In this context, standards and best practices are given due consideration whenever legislative proposals are initiated. Directive 2011/85, while being prepared in a very short

time, was based on prior analytical work of the Commission, which also incorporated notions from the relevant economic literature. It is also important to note that, while the literature includes a large variety of concepts and features related to medium-term fiscal planning, a universally accepted set of international best practices does not exist.

While acknowledging the importance of the elements presented as ‘differences’ in Table 1, the Commission is of the view that not all of them should necessarily qualify as legally binding EU standard for MTBFs. When preparing legislative proposals, the Commission has to carefully consider many aspects, including notably the right balance between the desirability of the envisaged requirements and the feasibility of translating them into EU law requirements applicable to all the Member States or the euro area Member States only.

The Commission also stresses the need to make the distinction between the MTBFs in the Commission approach (defined in Article 2(e) of the Directive) and the various concepts used by the IMF, the World Bank and the OECD. Directive 2011/85 focused on a particular concept of instrument for medium-term fiscal planning (i.e. MTBF) and on related basic principles and components that were deemed crucial to attaining the objective of promoting compliance with the EU fiscal framework. This explains the absence of some of the standards/best practice retained by the above-mentioned international organisations (e.g. carryovers, commitments and buffers).

31 The Commission recognizes that medium-term planning and annual budget preparation should be done in consistency with each other. Directive 2011/85 militates explicitly for such consistency, notably in Art. 10.

32 While acknowledging that the principle of ensuring expenditure control in MTBFs is important, the Commission considers that most of the cited control mechanisms would have been too specific/prescriptive to include in the Directive as common requirements for all Member States.

33 Directive 2011/85 does not foresee an accountability mechanism for ex-post or ex-ante deviations from the multi-year plans. However, the Fiscal Compact establishes correction mechanisms which are meant to address those departures from medium-term fiscal plans that would qualify as observed significant deviations from the MTO or the adjustment path towards it. Related opinions by the national IFIs would also activate the ‘comply-or-explain’ principle and generate a reputational cost for the budgetary authorities.

34 The 2017 draft Directive aimed specifically at strengthening the medium-term orientation of fiscal policy in the Member States by putting forward several key requirements for reinforcing MTBFs (see Commission reply to paragraph 21). The Commission stresses the high potential of those provisions to strengthen the MTBFs, despite the fact that they do not match directly the “differences” identified in Table 1.

As regards expenditure growth, Member States are also required by the SGP to respect the EU expenditure benchmark, which links the growth of expenditure with the evolution of the potential output.

35 The Commission was a pioneer in putting forward principles underpinning the establishment of national IFIs, via the June 2012 Communication regarding common principles on national fiscal correction mechanisms. Those principles were subsequently endorsed by the co-legislators as they were fully taken up in Regulation 473/2013. The specifications in the common principles provide key features for setting up or designating independent and competent bodies to operate in the fiscal policy area.

36 The Commission considers that the principles and desirable features for national IFIs issued by the OECD and IMF are in fact largely consistent with the EU level requirements, while being slightly more granular and operational. The differences are explained by the fact that such principles/features are meant to be used as a guidance and not as legally binding requirement. Moreover, not every ideal IFI feature is necessarily suitable for incorporation into EU law as requirement for all Member States, especially on subsidiarity grounds. Having one-size-fits-all IFIs (e.g. by imposing specific requirements on the number and term length of the board members or ways to finance the IFI activities) was therefore not in the Commission's intention and would have not reflected the will of the Member States at the time.

It should also be stressed that Member States were in favour of retaining a significant degree of freedom in designing their IFIs under the umbrella of common principles. This should also be seen against the fact that existence of IFIs in some Member States predated the supranational legislation, and some IFIs with varied set-up were operating successfully in diverse national settings.

39 The Commission underlines that the scope of improvements related to IFIs in the draft 2017 Directive is broader than suggested in this paragraph. Apart from additional competences for IFIs in relation to setting and monitoring key fiscal parameters and the incorporation of the 'comply-or-explain' principle into EU law, the proposal brings important qualifications for the independence safeguards as well as the possibility to extend all those IFI requirements to non-euro area Member States.

More concretely, the independence requirements were strengthened as follows: a reinforcing adjective was included for describing resources ("stable") and there were specifications for the right of access to information ("extensive and timely"); these qualifications aim to cater for concerns expressed by IFIs, including via the cited statements of the Network of EU IFIs.

42 The EU legislation concerning the multilateral budgetary surveillance lays down the specific responsibilities of the Commission as regards monitoring the Member States' compliance with the EU fiscal rules. While the Commission can take into account all available elements which are deemed useful, including as appropriate the information provided by the national IFIs, the legal framework in force does not foresee a formal involvement of IFIs in the EU budgetary surveillance.

46 While the TSCG, just as the SGP, indeed requires being at the MTO or on the adjustment path towards it, it additionally specifies a lower limit of the structural deficit of 0.5% of the GDP (or 1% under certain circumstances).

47 The Commission notes that even where IFIs monitor compliance with EU fiscal rules they may not necessarily all publish their assessments of compliance.

49 Common reply to paragraphs 49-51:

According to the Treaties, it is the Commission's duty to formally assess compliance with EU fiscal rules in the framework of multilateral budgetary surveillance. EU law does not confer upon IFIs any competence related to the process of assessing compliance with EU fiscal rules. In the few cases in which IFIs do conduct such activities, this is either based on a national legal obligation or done on a voluntary basis. The Commission acknowledges that, in such cases, differences may arise between IFIs' and the Commission's assessments of compliance. These may be due to, for example, differences of interpretation of underlying legal texts. Conclusions may also diverge because of IFIs using own or adapted methodologies which may not be fully consistent with the methodology used by the Commission for its assessment, or time lags between the assessments (as newer or more complete data can weigh on the assessment).

The use by the Commission of the discretion given to it by the legal texts that underlie the SGP can also contribute to such differences. However, the Commission has made use of the flexibility existing within the SGP in line with the commonly agreed position endorsed by the Council in February 2016. Accordingly, the Commission's assessments in recent years have allowed for three factors: 1) cyclical conditions (via the so-called 'matrix of requirements'); 2) structural reforms; and 3) government investment aiming at, ancillary to, and economically equivalent to major structural reforms.

Decisions taken by the Commission on cases of possible deviations from the required adjustment will be accompanied by a detailed reasoning and will subsequently be extensively discussed with the Member States along the ECOFIN filière. Where the Commission has used the discretion given to it, it has provided additional guidance throughout the cycle, thus limiting the uncertainty faced by IFIs in making their assessments.

Finally, the Commission points out that evidence so far suggests that there have only been a small number of instances when IFIs and the Commission reached different conclusions on Member States' compliance with the EU fiscal rules.

53 The Commission sees close cooperation with IFIs as an important pre-requisite for an effective functioning of the EU and national fiscal frameworks.

57 The advisory EFB was envisaged as a body to provide independent advice on the EU fiscal governance framework. Its statutory basis (i.e. Commission Decision (EU) 2015/1937) confirms that rationale by setting out the Board's mission as follows: "*The Board shall contribute in an advisory capacity to the exercise of the Commission's functions in the multilateral fiscal surveillance as set out in Articles 121, 126 and 136 TFEU as far as the euro area is concerned.*" This is further operationalised into a broad range of tasks and responsibilities (as per Article 2(2) of the cited decision, according to what was deemed essential for fulfilling EFB's mission.

It is in the context of this general mission that the 'coordination' of national fiscal councils should be read. However, conferring upon the advisory EFB a coordination role over independent institutions grounded in national laws (sometimes at constitutional level) would have required EU legislation, i.e. a potentially lengthy legislative process. Moreover, it could have dented the IFIs' independence and their public perception as home-grown 'fiscal watchdogs'.

60 The Commission underlines that the EFB's statutory regime and its resource allocation, although not fully conforming to the standards applicable to the national fiscal councils, were carefully designed and calibrated to ensure that the Board is fully capable of achieving its mission while securing the necessary independence standards.

While a strict parallel between the independent advisory EFB and the national independent fiscal councils cannot be drawn, the essence of the principles applicable to the latter is captured in the Board's set-up, with a particular focus on independence and competence and taking into account the specificity of the Board's mission.

a) The specifications regarding the mandates of the Board members are in line with national fiscal council practices in a number of Member States.

b) The Commission has a high regard for the EFB's activity, which brings an additional competent and independent view into the fiscal policy debate. The Commission is fully aware of the importance of independence for the reputation and credibility of EFB's advice.

c) Considering the special administrative set-up of the EFB as an advisory body to the Commission, the Secretariat-General of the Commission ensures the management of EFB's human and budgetary

resources according to the Commission's applicable rules. The arrangements in place have not curtailed the operations of the Board and its secretariat. In fact, the allocations for supporting the activity of the Chair and Board members have been increased significantly since inception. For example, all mission requests launched by the EFB secretariat have been approved and financed.

d) Those administrative support arrangements do not hinder the EFB's independent work and are actually meant to facilitate the EFB's operation in a cost-effective manner.

61 As explained in the letter from the Vice-President of the Commission to the Ombudsman referred to in paragraph 67, a strict parallel between the independent advisory EFB and the national independent fiscal councils cannot be drawn. In particular, not only the underlying legal bases are different but most importantly their institutional set-up, roles, functioning and powers are different. The former is an independent advisory body of the Commission. The Commission's responsibilities with respect to the surveillance of fiscal policies of the Member States are enshrined in the Treaty. At national level, according to the EU law and the intergovernmental TSCG, Member States have put in place independent institutions to monitor national public finances.

Overall, the Commission considers that the Board's set-up takes appropriately into account the relevant standards and lays a solid groundwork for the EFB's mission.

62 The Commission underlines that Decision 2015/1937 does not restrict the Board's actions in the fulfilment of its remit.

The EFB mandate does not exclude the possibility to formulate advice/opinions in real time. The Board decided to give preference to an ex-post assessment of the implementation of the Union fiscal rules for at least two important reasons: (i) A real-time assessment of key surveillance decisions at the EU level would be extremely resource intensive. Unlike national fiscal councils, the EFB would have to provide a solid analysis for all Member States in a very short period of time; (ii) Focusing on the ex-post assessment of how the Union fiscal rules are implemented reduces the risk of getting into political debates and bolsters the capacity of any independent fiscal council to provide a non-partisan/independent view. Moreover, it is not entirely clear that real-time assessments would have a bigger impact than those delivered ex post.

65 The EFB annual reports do highlight various weaknesses and challenges facing the IFIs, but they also go beyond and put forward suggestions on how to address shortcomings. For example, the 2017 annual report makes in the dedicated section on IFIs several suggestions for making the 'comply-or-explain' principle more effective.

66 Common reply to paragraphs 66 and 67:

The Commission takes into account all available elements which are deemed useful for its informed decision-making. This includes the inputs provided by the advisory EFB, where appropriate. However, given that its fiscal surveillance responsibilities are enshrined in the Treaties, the process by which the Commission arrives at decisions in this area cannot be constrained, for example by regulating if, how and when the EFB advice and opinions would be taken into account.

With respect to the 'comply-or-explain' principle, the letter from the Vice-President of the Commission to the Ombudsman referred to in paragraph 67 explained that a strict parallel between the independent advisory EFB and the national independent fiscal councils cannot be drawn as the underlying legal bases, the institutional set-up, roles, functioning and powers are different (see Commission reply to paragraph 61). At national level, according to the TSCG, signatory Member States have put in place independent institutions to monitor whether national policies ensure rapid



convergence towards the country-specific medium-term objective. This is why a "comply-or-explain" principle applies in that specific context for the TSCG Contracting Parties.

68 See Commission reply to paragraph 60. Concerning the issue of independence, Commission Decision 2015/1937 (Article 4) includes an explicit provision regarding independence of the Board members.

69 Different legal instruments may be used to lay down requirements which differ in terms of level of prescriptiveness and leeway given to the Member States.

Specifically regarding Directive 2011/85, in the course of its preparation it became clear that a Council Directive was the most suitable vehicle for legislating for the first time in the area of NBFs, which touches on the sovereign fiscal competences of the Member States. The choice was mainly predicated on the specific nature of provisions to be included in the legislative proposal (against very diverse NBF baselines in the Member States at the time), the competences it touches upon and the need to take into account national ownership and subsidiarity principle considerations (see also the Commission reply to paragraph 19). The Commission also points out that this step only became politically possible in the wake of the crisis and, as a first legislative foray in the NBF area, an overly prescriptive approach in the Commission proposal would very likely not have been deemed acceptable by the Member States, thereby risking to put into question the adoption of any legal provisions on NBFs.

74 The Commission stresses that transposition and conformity checks have been very thorough to ensure that requirements are fully and correctly taken up in the national NBF legislation.

The national transposition processes themselves took considerable more time than envisaged. The adoption of further NBF requirements (see paragraph 72) induced delays for the Member States beyond the transposition deadline set for the Directive (e.g. some national implementing measures were notified during 2014-2016, and a few even later).

Regarding the checks conducted by the Commission, apart from the complexity of analysing thoroughly a whole raft of NBF legislation in place in the Member States, during the above-mentioned period a significant amount of effort also went into assessing the compliance of national legal provisions of 22 TSCG Contracting Parties with the Fiscal Compact requirements (as per the invitation made to the Commission in Art. 16 TSCG).

Finally, the process of compliance checking involved extensive bilateral exchanges with the Member States (primarily via the EU Pilot process) aiming to remedy the transposition gaps and non-conformity issues identified by the Commission. While these exchanges have been very effective, the corrective actions taken by the Member States in turn generated further delays in completing the conformity checks.

As regards the targets set in DG ECFIN's Annual Management Plans, it should be noted that they refer only to the preliminary conformity checks, i.e. the basis for the EU Pilots. In some cases, this was due to the reason explained above.

76 On deciding the sequencing of EU Pilots for a Directive which establishes minimum requirements for NBFs of all Member States, the Commission considers that the more operational criteria it used (as indicated in paragraph 76) were more appropriate from an equal treatment point of view than those cited by ECA (namely, the level of public debt and membership of euro area).

The Commission points out that half of the high-debt euro area Member States were in fact covered among the 18 Member States that were included in the first and second waves of EU Pilots.

78 The Commission stresses that the EU Pilot exchanges have been instrumental for the conformity checks. They enabled to form a definitive view on conformity for the 18 Member States concerned by the first two waves and, on that basis, either conclude on conform transposition or consider the need for launching infringement proceedings where Pilot replies were rejected as unsatisfactory.

It should be noted that the 10 weeks for each side involved in the EU Pilot (i.e. the Commission and the Member State concerned) represent a benchmark. The overall duration of a Pilot case may be longer in practice for a variety of reasons, such as: (i) request for an extension from the Member State, (ii) request for additional information from the Commission; (iii) time necessary for translation of Member States replies and submissions, and (iv) reporting of follow-up measures by the Member State. Some or all of the above situations were encountered in all the 18 cases, which explains in part the long span of the exchanges with the Member States. In particular, it should be noted that in all those Pilot cases the Commission requested additional information.

The Commission services involved (i.e. DG ECFIN) adopted a constructive conduct during the EU Pilot exchanges, especially by giving Member States all the necessary assistance and allowing time for some committed measures to be adopted. This lengthened the formal duration of the Pilot cases beyond the benchmarks, but the relevance of this delay is clearly outweighed by the positive outcome of the process: only 7 out of the 18 cases were closed with a rejection, and the outstanding issues in 6 out of those 7 cases have subsequently been settled satisfactorily by the Member States concerned, without the Commission needing to launch infringement proceedings.

79 Common reply to paragraphs 79 and 80:

With hindsight, the Commission acknowledges that it may have underestimated the challenges associated with the national transposition of the Directive, to a certain extent. An important reason behind the Member States' delay in notifying transposing measures was that they also had to incorporate in the national legal order the additional NBF requirements stemming from Regulation 473/2013 and the Fiscal Compact. In particular, the latter required passing legislation with high legal force in the national legal hierarchy, sometimes even at constitutional level. Member States were therefore slower in adopting and notifying the Directive-related measures, leading to the launch of non-communication infringement procedures.

The Commission points out that it provided guidance and support on NBFs both before and after the Directive's transposition deadline of 31 December 2013. This was done via several means and channels, in particular topic-specific guidance documents (e.g. on statistical requirements, information on tax expenditure), notes to the relevant committees, background papers for peer reviews on NBFs, review of draft national legislation transposing the Directive (including before 31 December 2013), EU Pilot procedures (as of August 2016), and other bilateral technical exchanges. Moreover, the Commission has always responded favourably to any specific request for assistance addressed to it by the Member States.

When assessing the full extent of guidance on NBFs provided by the Commission to the Member States, one has to consider that Member States overhauled their fiscal frameworks by taking into account not just the Directive requirements, but also obligations stemming from Regulation 473/2013 and the Fiscal Compact, as applicable. Therefore, when reviewing draft national legislation and providing comments, the Commission also factored in the broader set of supranational NBF requirements to which Member States need to abide by.

In its Treaty role of monitoring the application of EU law, the Commission has indeed prioritised so far ensuring that the features of reformed NBFs are in line with the new requirements of Union law, as

they prompted significant reforms of NBFs across the EU. Given the forthcoming completion of the conformity checks for Directive 2011/85, the Commission's focus will shift towards the implementation of NBFs, including as appropriate the provision of support and guidance.

83 The Commission envisages to start assessing how Directive 2011/85 is applied after concluding the conformity checks. While the Commission's focus has so far been on ensuring proper transposition, implementation-related information has also been collected to get a better picture of the overall situation in the Member States. However, this has not been done in a systematic way and will require an across-the-board update at the time of conducting full application checks.

84 Internal guidelines for formal application checks will be prepared before engaging in those checks. Notwithstanding this, it should be noted that on a number of Directive provisions which are more implementation-oriented than transposition-driven (e.g. statistical provisions), the internal transposition guidance actually includes elements of guidance for application checks.

85 Common Commission reply to paragraphs 85 and 86:

The Commission acknowledges the relevance of further analysis and will continue to explore ways in which useful results could be achieved.

However, the Commission stresses that making a strict correlation between a Member State's implementation of the Directive (which is a subset of the supranational NBF requirements) and its overall fiscal performance in relation to the SGP requirements is very challenging methodologically. While assessing the degree of implementation and functioning of the Directive provisions is relatively straightforward, assessing the extent to which these requirements have affected fiscal performance is less clear, mainly because of:

- high degree of overlap between certain requirements of the Directive and provisions laid down in Regulation 473/2013 and the Fiscal Compact that produced effects during the same period.
- the timing of the Directive, which coincided with a deep financial and economic crisis during which several Member States were under external financial assistance programmes (most of those programmes contained conditionalities that took on board many of the Directive requirements).
- the need to allow sufficient time for the Directive requirements to be applied in practice and exert their influence on the budgetary process.

86 The suitability of the PEFA methodology for assessing the operational performance of key elements of NBFs can be assessed among various options.

88 The Commission underlines that there is no legal requirement to include review clauses in legislative proposals.

89 The Commission has decided to postpone the publication of the suitability review and to publish it together with the review of other parts of the Six and Two-pack. This will allow the Commission to form an aggregate view on the whole EU fiscal framework, consisting of EU rules and national fiscal frameworks.

91 The Fiscal Governance Database (FGD) and the related indices were established for a broader purpose than the assessment of requirements in EU law (incidentally, their creation predates the Directive 2011/85). The MTBF index was designed from the outset to reflect desirable features and best practices for MTBFs, thus going beyond the Directive, which sets only minimum requirements

for MTBFs. In fact, the Commission considers that an index taking into account only the requirements from the Directive would be of limited relevance. The MTBF index was also not designed as a measure of the transposition or implementation of the Directive in the area of MTBFs. It should be noted, however, that after the 2015 methodological review of the FGD the index criteria have been refined in light of the improvements recorded in the Member States and have been better aligned with (most of) the requirements of the Directive.

Currently the MTBF index serves a range of purposes, such as peer-reviews in ECOFIN preparatory committees, Commission's monitoring of NBFs and analytical work.

92 While the study does not purport to be a fully-fledged assessment on the application of EU requirements concerning MTBFs, it provides evidence on the effectiveness of national fiscal rules and MTBFs in the EU.

First indent: The MTBF index is indeed compiled based on information reported by the Member States in the FGD. This is in line with the original mandate given by the ECOFIN Council via its conclusions adopted on 5 May 2009. In time, and especially after the 2015 FGD review, the amount of MTBF-related information reported in the FGD has increased noticeably and its level of detail justifies continuing to rely on the Member States (i.e. Ministries of Finance) as information providers. It should also be stressed that in recent years the information submitted by Member States has been increasingly verified against in-house Commission knowledge and in many cases corrected before entering the index. This has increased the reliability of the index.

Second indent: As indicated in the reply just above, the MTBF index was designed from the outset to reflect desirable features and best practices for MTBFs. Thus, not each and every provision in the Directive is taken into account in the scoring, while in turn some criteria go beyond the scope of the Directive.

Third indent: By design, the MTBF index focuses exclusively on elements of design, for which information is available in the FGD.

Fourth indent: While the MTBF index was neither designed nor used as a measure of the transposition or implementation of the Directive, reforms introduced by the Member States in response to the Directive are reflected by the index as they are adopted and reported in the FGD, independent of the timing of the Directive assessment (the index scoring and the Directive assessment follow separate processes). In other words, for the purposes of the study in question, the MTBF index covers the structural features that were in place in the Member States up until end-2015. Accordingly, subsequently adopted reforms are not covered by the MTBF index series used in the study.

Fifth indent: Whereas the MTBF index provides a numerical measure of the design quality of MTBF across Member States, it cannot track the reasons underlying the changes to the index, such as the financial assistance programmes. As pointed out in the Commission reply to paragraphs 85 and 86, isolating the specific impact of the Directive 2011/85 from other factors influencing NBF reforms is very challenging methodologically. This is true also for the financial assistance programmes, most of which contained conditionalities that took on board many of the Directive requirements.

95 As regards the reference to the Contracting Parties' commitments in the Commission's assessment, it should be recalled that the Fiscal Compact is not an instrument of Union law. The Commission found it therefore appropriate to take a relatively flexible approach, according to which formal commitments and announced plans of the Contracting Parties are considered to complement and reinforce the adopted national provisions. The Commission does not consider that the approach led to weakening the requirements applicable to the Contracting Parties.

The Commission acted in full transparency by publicly referring in the report to the commitments and plans announced by the Contracting Parties. That clarity as to the analytical framework used, and as to the specific issues for which the commitments or announced plans were taken into account by the Commission when arriving at its conclusions, left the Contracting Parties (i.e. the intended recipients of that report) fully informed.

It should also be noted that in the discussions in the ECOFIN preparatory committees which followed the release of the report (i.e. during 2018-2019), the Contracting Parties did not challenge the Commission's use of commitments in assessing compliance.

## **CONCLUSIONS AND RECOMMENDATIONS**

99 According to the Treaties, it is the Commission's duty to formally assess compliance with EU fiscal rules in the framework of multilateral budgetary surveillance. EU law does not confer upon IFIs any competence related to the process of assessing compliance with EU fiscal rules, even though some IFIs conduct such activities pursuant to a national legal obligation or on a voluntary basis.

100 Differences may indeed arise between IFIs' and the Commission's assessments of compliance, for various reasons (see Commission reply to paragraphs 49-51). While the discretion given to the Commission by the legal texts that underlie the SGP can contribute to those differences, the Commission stresses that it undertakes its assessments of Member States' compliance with the EU fiscal rules in a rigorous and transparent way and making appropriate use of the flexibility existing within the rules, in line with the commonly agreed position endorsed by the Council in February 2016. The results of those assessments are subject to consultation with the Council (and through it, with the Member States) through the relevant fora (i.e. ECOFIN and its preparatory committees).

In the Commission's view, the assessment inconsistency risk can be mitigated through regular exchanges and sharing of information between the Commission and the IFIs, as already undertaken by the Commission.

### **Recommendation 1 – Compliance assessments by the Commission and the independent fiscal institutions**

The Commission accepts the recommendation.

The Commission sees close cooperation with IFIs as an important pre-requisite for an effective functioning of the EU and national fiscal frameworks.

101 The basic requirements for MTBFs and the establishing criteria for IFIs are largely consistent with the relevant literature and international practices. In fact, in some respects the Union is a standard-setter, most notably as regards the mass establishment of IFI entrusted to monitor national fiscal rules and produce/endorse macroeconomic forecasts for fiscal planning.

Given the existing differences among national budgetary systems in the EU and ownership and subsidiarity considerations, not any ideal feature of MTBFs or IFIs would be suitable for incorporation into EU law.

In fact, some of the principles/features promoted by the IMF and OECD are sometimes very granular or operational as those are meant to be used as detailed guidance, as opposed to legally binding requirements.

Notwithstanding this, the Commission does not wish to claim that there is no room to improve EU legal requirements for NBFs (as attested by its 2017 Directive proposal) or the way in which they are applied by the Member States.

## **Recommendation 2 – Review requirements for national budgetary frameworks**

The Commission accepts the recommendation.

The upcoming review of Six- and Two-pack provides the opportunity to identify the strength and weaknesses of NBF requirements based on the experience so far with their transposition and implementation.

102 The EFB's statutory regime and its resource allocation were carefully designed and calibrated in order to ensure that the Board is fully capable of achieving its mission. As regards the 'comply-or-explain' principle, the Commission reiterates its view that a strict parallel between the EFB and national fiscal councils cannot be drawn (see Commission reply to paragraphs 66-67).

## **Recommendation 3 – Strengthen the European Fiscal Board**

The Commission does not accept the recommendation.

It considers that the current set-up is fit-for-purpose and has not constrained the Board's analytical and functional independence. Moreover, modifying the EFB role and set-up would pre-empt the outcome of the forthcoming review of the Six- and Two-pack, which may have implications for the EFB's role in the EU fiscal governance framework.

The EFB has duly exercised its functional independence and has so far delivered appropriately on its given mandate. Its outputs are duly considered in the EU-level fiscal policy debate and the Chair of the EFB is regularly invited to present the Board's views at the ECOFIN Council and the Eurogroup.

103 The Commission has been conducting thorough compliance checks with respect to Directive 2011/85, to ensure that the respective requirements are properly embedded into the Member States' budgetary frameworks. The conformity checks are virtually completed for two-thirds of the Member States and ongoing for the remainder. The Commission services involved (i.e. DG ECFIN) have used effectively the EU Pilot exchanges conducted in the framework of the conformity checks.

104 The assessments mandated by the EU legal framework are conducted in accordance with the specific review clauses included in both Directive 2011/85 and Regulation 473/2013. The forthcoming review of the Six- and Two-pack will provide an opportunity to take an in-depth and holistic look at what the various requirements on NBFs have delivered so far.

## **Recommendation 4 – Strengthen enforcement of national budgetary frameworks**

The Commission accepts the recommendation.

b) The suitability review will be published together with the review of other parts of the Six and Two-pack.

c) The Commission acknowledges the usefulness of collecting on a regular basis information from the Member States on the actual functioning of the NBFs. The Commission will work to identify the type of information that would be necessary and the most appropriate process and tools for collecting that information. Importantly, the Commission stresses that the implementation of this recommendation will hinge on the cooperation of the Member States in providing the necessary information.

d) The Commission acknowledges the importance of monitoring more closely the actual functioning of Member States' budgetary frameworks. It should be noted that such monitoring requires detailed information to be provided by the Member States, which would then be assessed by the Commission based on an appropriate methodology.

## Audit team

The ECA's special reports set out the results of its audits of EU policies and programmes, or of management-related topics from specific budgetary areas. The ECA selects and designs these audit tasks to be of maximum impact by considering the risks to performance or compliance, the level of income or spending involved, forthcoming developments and political and public interest.

This performance audit was carried out by Audit Chamber IV Regulation of markets and competitive economy, headed by ECA Member Alex Brenninkmeijer. The audit was led by ECA Member Neven Mates until the end of his mandate (July 2019) and thereafter by ECA Member Mihails Kozlovs, supported by Edite Dzalbe, Head of Private Office and Laura Graudina, Private Office Attaché; Marko Mrkalj, Private Office Attaché; Marion Colonerus, Principal Manager; Stefano Sturaro, Head of Task; Giuseppe Diana, Efstathios Efstathiou and Maëlle Bourque, Auditors. Michael Pyper provided linguistic support.



*From left to right: Stefano Sturaro, Marion Colonerus, Mihails Kozlovs, Maëlle Bourque, Giuseppe Diana, Efstathios Efstathiou.*

# Timeline

Event	Date
Adoption of Audit Planning Memorandum (APM) / Start of audit	13.12.2018
Official sending of draft report to Commission (or other auditee)	18.7.2019
Adoption of the final report after the adversarial procedure	15.10.2019
Commission's (or other auditee's) official replies received in all languages	22.11.2019



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This report assesses whether the Commission's post-crisis action to strengthen the EU Member States' budgetary frameworks achieved the intended results. The EU's legislative action provided impetus; however, the legal framework leaves room for improvement and the Commission has so far only limited assurance that Member States properly apply the EU requirements. Besides, there is a risk of divergences between the Commission's and the Independent Fiscal Institutions' assessment of compliance of national annual and medium-term fiscal plans with EU fiscal rules, which could reduce the effectiveness of the EU fiscal framework. Finally, the effectiveness of the European Fiscal Board is limited by its current institutional set-up and the fact that the Commission can ignore its advice without providing appropriate explanation.

ECA special report pursuant to Article 287(4), second subparagraph, TFEU.



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