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COMMISSION STAFF WORKING DOCUMENT

**Review of the suitability of the Council Directive 2011/85/EU on requirements for
budgetary frameworks of the Member States**

Accompanying the document

**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE
EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE
OF THE REGIONS**

Economic governance review

**Report on the application of Regulations (EU) No 1173/2011, 1174/2011, 1175/2011,
1176/2011, 1177/2011, 472/2013 and 473/2013 and on the suitability of Council Directive
2011/85/EU**

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¹ Six pack: Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011 on the effective enforcement of budgetary surveillance in the euro area, OJ L 306, 23.11.2011, p. 1; Regulation (EU) No 1174/2011 of the European Parliament and of the Council of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area, OJ L 306, 23.11.2011, p. 8; Regulation (EU) No 1175/2011 of the European Parliament and of the Council of 16 November 2011 amending Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, OJ L 306, 23.11.2011, p. 12; Regulation (EU) 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances, OJ L 306, 23.11.2011, p. 25; Regulation (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, OJ L 306, 23.11.2011, p. 33; Directive 2011/85/EU of the Council of 8 November 2011 on the requirements for budgetary frameworks of the Member States, OJ L 306, 23.11.2011, p. 41; Two-pack: Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, OJ L 140, 27.5.2013, p. 1; Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, OJ L 140, 27.5.2013, p. 11.

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1. INTRODUCTION

Directive 2011/85/EU on requirements for national budgetary frameworks of the Member States² was adopted in November 2011. It was part of a package of legislative initiatives (the ‘six-pack’) presented by the Commission in response to the worldwide economic and financial crisis. It was the first piece of EU legislation setting EU-level minimum requirements for national budgetary frameworks. Directive 2011/85 contains requirements concerning the main elements of national budgetary frameworks, namely with respect to:

- systems of budgetary accounting and statistical reporting;
- rules and procedures governing the preparation of forecasts for budgetary planning;
- country-specific numerical fiscal rules;
- medium-term budgetary frameworks;
- transparency of public finances and mechanisms that regulate fiscal relationships between public authorities across sub-sectors of general government.

This staff working document accompanies the Commission Communication on the economic governance review.³ Article 16 of Directive 2011/85 requires the Commission to publish a ‘review of [its] suitability’. The Commission has carried out that review in the context of a general review of EU economic governance. This staff working document supports the review of Directive 2011/85, given the specific nature of the review clause in Article 16 (see Box 1). It contains background analysis and technical information supporting and supplementing the Commission’s views presented in its Communication.

Box 1. Council Directive on requirements for budgetary frameworks of the Member States

Article 16

1. By 14 December 2018 the Commission shall publish a review of the suitability of this Directive.
2. The review shall assess, inter alia, the suitability of:
 - (a) the statistical requirements for all sub-sectors of government;
 - (b) the design and effectiveness of numerical fiscal rules in the Member States;
 - (c) the general level of transparency of public finances in the Member States.

[...]

² Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, OJ L 306, 23.11.2011, p. 41.

³ COM(2020) 55

The review clause in Article 16 determines the nature and content of the review:

- **it envisages a one-off review of suitability.** As Directive 2011/85 was the first EU’s legislative initiative setting out requirements for national budgetary frameworks, the purpose of the review is to inform the legislator whether that EU intervention has delivered on its objectives and whether it has been ‘suitable’. Therefore, the staff working document reviews experience with Directive 2011/85 so far, notably in terms of its transposition into the Member States’ legal order and implementation of its requirements in practice. The primary focus of the analysis is on the period since its entry into force on 13 December 2011;
- **the requirement to assess the ‘suitability’ of Directive 2011/85 is relatively open.** It is not, however, a weakness of the review clause. On the contrary, because Directive 2011/85 covers a wide and varied range of issues, the broad wording of the clause means that the assessment approach can be tailored to each of the areas in the most appropriate way;
- **Article 16 emphasises several areas of Directive 2011/85 (see Box 1), but does not restrict the review to them** (note the use of ‘*inter alia*’). The Commission’s review therefore covers the whole Directive, given the interlinkages between its various parts.

The analysis and conclusions set out below take account of the fact that Directive 2011/85 was the first but not the only legislative initiative in the area of national budgetary frameworks. Other initiatives have also had profound impacts on Member States’ actions in this area. Therefore, identifying its impact, as opposed to that of the other EU and EU-level instruments, is in general challenging and often involves a large degree of judgment. For that reason, the Commission is undertaking a comprehensive and holistic assessment of the EU fiscal framework and the legislation concerning national fiscal frameworks in this and related documents.⁴ The subsequent sections will return to that issue in more specific terms when discussing the individual parts of Directive 2011/85.

This staff working document has been prepared using information collected through multiple processes and channels. It includes information gathered for the purposes of checking compliance with Directive 2011/85. In addition, the Commission services regularly collect information on the design and functioning of national fiscal frameworks and make it available in a structured manner in the Fiscal Governance Database maintained by the Commission’s Directorate General for Economic and Financial Affairs.⁵ Unless otherwise noted, the cut-off date for information taken into account for the analysis is December 2019.

The analysis presented here has been greatly enhanced by a wide survey of Member State practitioners involved in the implementation of Directive 2011/85. Specifically, the survey involved the Member States’ ministries of finance (as the main ‘operators’

⁴ COM(2020) 55, SWD(2020) 210

⁵ https://ec.europa.eu/info/business-economy-euro/indicators-statistics/economic-databases/fiscal-governance-eu-member-states_en

affected by Directive 2011/85), statistical offices and independent fiscal institutions (IFI). The document reflects views of the surveyed experts throughout the text, with more details presented in the Annex.

The structure of this staff working document broadly follows the structure of Directive 2011/85. Section 2 provides background information about the Directive itself – it recalls the history of its adoption, its objectives and the specific tools provided to achieve them. Section 3 contains the main analysis organised in sub-sections corresponding to the building blocks of Directive 2011/85. All the sub-sections have a similar structure, first setting out the Directive’s provisions and their rationale, followed by a description and analysis of key developments in the area concerned in terms of national transposition and implementation. Two of the sub-sections, namely those on the numerical fiscal rules and the medium-term budgetary frameworks, include additional analysis looking into the effectiveness of those fiscal devices in the light of the Directive’s provisions. Finally, Section 4 summarises and concludes the overall analysis.

2. DIRECTIVE 2011/85 – CONTEXT, RATIONALE AND MAIN ELEMENTS

Directive 2011/85 was part of the EU’s attempt to improve its economic governance as a response to the crisis. While the global economic and financial crisis originated elsewhere, the EU was profoundly affected. The economic and financial shock exposed weaknesses in Member States’ economies and put into question the effectiveness of the EU’s economic surveillance. While the sources of those weaknesses were very diverse and not necessarily fiscal in nature, the crisis led to a sudden and dramatic deterioration of fiscal accounts. This was primarily due to the sharp economic downturn, but also to the insufficient reduction of debt before the crisis. The rapidly deteriorating fiscal positions, in some Member States in particular, undermined financial market confidence, leading to a sharp increase in government bond yields. Financing costs reached unsustainable levels in several Member States and required EU and international financial assistance.

As a response to those developments and to address the shortcomings in pre-crisis economic surveillance, the Commission sought to strengthen and broaden economic policy coordination. In September 2010, the Commission published a package of legislative proposals (the ‘six-pack’), which strengthened the Stability and Growth Pact (SGP) and extend EU surveillance to macroeconomic imbalances. The package also contained a proposal for a Council Directive on requirements for budgetary frameworks of the Member States.

The imperative of strengthening Member States’ fiscal governance rested on a vast body of economic literature illustrating the benefits of fiscal frameworks for conducting sound fiscal policies. Strong rule-based domestic frameworks support fiscal responsibility with a view to attaining sound budgetary positions, in particular by containing the deficit bias, and to reducing the pro-cyclicality of fiscal policy choices (European Commission, 2010). Institutional settings at national level can play an important role in reining in spending and deficit biases; they include in particular:

- (i) the procedural rules of the budgetary process;
- (ii) the numerical fiscal rules guiding or constraining policy-makers’ discretion; and

- (iii) independent fiscal bodies or institutions in charge of providing inputs (e.g. forecast, analysis) and formulating recommendations in the area of fiscal policy (European Commission, 2006).

While some research shows that fiscal rules have sustained fiscal discipline in a significant number of countries (Guichard *et al.*, 2007), other papers emphasise the importance of well-designed budgetary procedures in ensuring the centralisation of the budget formulation (von Hagen *et al.*, 2002). Other contributions analyse the effect of specific characteristics of fiscal frameworks on budgetary performance. For example, countries implementing stronger rules over a larger share of general government finances were found to register better budgetary outcomes (Debrun *et al.*, 2008), whilst effective medium-term budgetary planning appears instrumental in sticking to budgetary plans (European Commission, 2007). The quality of domestic budgetary procedures was also shown to contribute to better budgetary performance (Fabrizio and Mody, 2006).

While the crisis was the immediate trigger for the proposal for Directive 2011/85, the focus on the national fiscal frameworks in Member States, on their role and importance had been steadily growing long before its adoption. First, given that the Treaty defines Member States' budgetary obligations in terms of the general government sector, Protocol No 12 on the excessive deficit procedure (EDP) annexed to the Treaties requires Member States to 'ensure that national procedures in the budgetary area enable them to meet their obligations in this area deriving from these Treaties'. Further, in the context of the first reform of the SGP in March 2005, the Council highlighted the importance of national budgetary frameworks in its report to the European Council on 'Improving the implementation of the Stability and Growth Pact'. The Council stressed the need for complementarity between the national frameworks and EU fiscal rules. In the Council's view, national rules should complement the Member States' commitments under the SGP and national governance arrangements should complement the EU framework. The Council considered that national institutions should play a more prominent role in budgetary surveillance to strengthen ownership, enhance enforcement through national public opinion and complement the economic and policy analysis at EU level.

Discussions on the role and desirable features of national fiscal frameworks continued along the ECOFIN filière within the Council. In May 2010, shortly before the publication of the draft Directive, the Council adopted *Conclusions on domestic fiscal frameworks*. The Council stressed the importance of resilient and effective fiscal frameworks for the implementation of the SGP and for the sustainability of public finances. While recognising the need for fiscal governance to take account of country-specific circumstances, it identified some desirable common features of resilient and effective fiscal frameworks and encouraged the Member States to enhance their fiscal governance arrangements. Among those features, the Council underlined the importance of comprehensive nature of fiscal frameworks and of strong national ownership. The Council also invited the Member States to strengthen their coordination arrangements across the levels of administration and to improve budgetary procedures. Fiscal rules, enforcement mechanisms and independent fiscal institutions were the elements that significantly contributed to the effectiveness of fiscal frameworks, as illustrated by successful country experiences.

Therefore, Directive 2011/85 should be seen as a further development of previous policy discussion on the design and role of national fiscal frameworks in the EU. The severity of the crisis showed that it was no longer sufficient to rely on voluntary

exchange of best practices and a more binding approach to national fiscal frameworks was necessary. Directive 2011/85 therefore set minimum requirements for Member States' national fiscal frameworks to ensure that they support compliance with budgetary obligations under EU law. Directive 2011/85 (recital 1) aimed in particular to specify the obligations of national authorities to comply with the provisions of Protocol No 12. That objective justifies the legal base of the Directive, which is the third subparagraph of Article 126(14) of the Treaty on the Functioning of the European Union (TFEU). It allows the Council 'on a proposal from the Commission and after consulting the European Parliament, lay down detailed rules and definitions for the application of the provisions of the said Protocol'.

The objective of achieving 'uniform compliance with budgetary discipline as required by the TFEU' (recital 28) was important to avoid situations in which a lack of fiscal prudence in a very small subset of Member States creates significant negative spillovers. The experience of the crisis also highlighted that EU budgetary requirements were not sufficiently internalised in fiscal policy-making at national level or at least not to the same extent in all Member States. Therefore, coordinated strengthening of fiscal frameworks, in line with the Directive's minimum requirements were also meant to contribute to enhancing national ownership of EU budgetary obligations in every Member State.

Enhancing policy transparency was an important element of the economic governance reform of 2010 in general and of Directive 2011/85 in particular. Specifically, the European Semester of economic policy coordination shifted the focus of multilateral surveillance at EU level from *ex-post* information on policy decisions to *ex-ante* discussion of their policy plans. The discussion on policy intentions among the Member States was intended to provide peer support to avoid policy mistakes. In the same vein, Directive 2011/85 created requirements for enhanced fiscal transparency at national level in terms of statistical data, forecasting methodologies, medium-term policy objectives and the transparency of the whole general government sector.

Directive 2011/85 has seven chapters. Chapter I lays down the purpose of the Directive and defines key terms. In particular, it defines the (national) budgetary framework as 'the set of arrangements, procedures, rules and institutions that underlie the conduct of budgetary policies of the general government', comprising the following main elements:

- a) systems of budgetary accounting and statistical reporting;
- b) rules and procedures governing the preparation of forecasts for budgetary planning;
- c) country-specific numerical fiscal rules, which contribute to the consistency of Member States' conduct of fiscal policy with their respective obligations under the TFEU, expressed in terms of a summary indicator of budgetary performance, such as the government budget deficit, borrowing, debt, or a major component thereof;
- d) budgetary procedures comprising procedural rules to underpin the budget process at all stages;
- e) medium-term budgetary frameworks as a specific set of national budgetary procedures that extend the horizon for fiscal policy-making beyond the annual budgetary calendar, including the setting of policy priorities and of medium-term budgetary objectives;

- f) arrangements for independent monitoring and analysis, to enhance the transparency of elements of the budget process;
- g) mechanisms and rules that regulate fiscal relationships between public authorities across sub-sectors of general government.

For those elements, Directive 2011/85 specifies a number of essential standards, grouped in subsequent chapters. Chapter II contains provisions on public accounting and statistics, in particular the availability of fiscal data. Chapter III lays down requirements for forecasts underlying fiscal planning. The provisions of Chapter IV require Member States to have in place numerical fiscal rules and set out their specifications. Chapter V covers medium-term budgetary frameworks, their elements and characteristics. Chapter VI concerns the transparency of general government finances and the comprehensive scope of budgetary frameworks, and Chapter VII contains final provisions, including the review clause. Directive 2011/85 entered into force in December 2011, with the Member States obliged to bring into force the provisions necessary to comply with it by 31 December 2013.⁶

After the adoption of Directive 2011/85, discussions on strengthening national fiscal frameworks continued, leading to further EU and intergovernmental initiatives. First, the Treaty on Stability, Coordination and Governance in the EMU (TSCG), an international treaty signed in March 2012, requires its signatories to introduce in the national legal order a structural budget-balance rule equipped with a correction mechanism and to set up a national independent institution to monitor its operation. Those provisions, which were part of the so-called ‘Fiscal Compact’ (Title III of the TSCG), apply to euro-area Member States and other Member States that declare a willingness to be bound by them (to date Bulgaria, Denmark and Romania)⁷. Second, Regulation No 473/2013 (part of the ‘two-pack’) introduced more specific requirements for the euro-area Member States on the monitoring of national fiscal rules by independent fiscal institutions, the use of independently produced or endorsed macroeconomic forecasts in budgeting, and on a common domestic budgetary timeline.

An interim report took preliminary stock of the transposition of Directive 2011/85 at the end of 2012, i.e. well before the transposition deadline. In line with Article 15(3) of Directive 2011/85, the Commission submitted to the European Parliament and the Council the ‘Interim Progress Report’ on the implementation of Directive 2011/85 to inform the Parliament, the Council and the public on the progress with its transposition⁸. The report, primarily based on information reported by the Member States, noted at the time substantial, but uneven progress. Since the expiry of the transposition deadline at the end of 2013, the Commission has assessed compliance in accordance with the applicable EU procedures.

To conclude, the aim of Directive 2011/85 was to pioneer the strengthening of Member States’ budgetary frameworks in the wake of the crisis, which then

⁶ In the framework of the Euro Plus Pact, the heads of state and government of the euro-area Member States committed in July 2011 to transpose the Directive ahead of time, i.e. by end-2012.

⁷ See also Communication from the Commission. The Fiscal Compact: Taking Stock. C(2017) 1200 final.

⁸ Interim Progress Report on the implementation of Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States. COM(2012) 761 final. http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/pdf/ocp128_en.pdf

received additional impetus from other EU and intergovernmental drivers. Directive 2011/85 remains the first and the most wide-ranging EU policy intervention with respect to specific requirements for national budgetary frameworks. It is also the only legal instrument in that field addressed to all Member States, as Regulation No 473/2013 applies to euro-area Member States only. Nevertheless, its action and effectiveness have to be seen as part of a broader set of complementary and mutually reinforcing EU-level initiatives on fiscal governance.

3. MAIN DEVELOPMENTS IN THE AREAS COVERED BY DIRECTIVE 2011/85

This section is organised in sub-sections corresponding to the building blocks of the Directive. Each sub-section first sets out the provisions of Directive 2011/85 and explains their rationale. The section follows with a description and analysis of key developments in terms of national transposition and implementation. The sub-sections on the numerical fiscal rules and medium-term budgetary frameworks include additional analysis looking into the effectiveness of these fiscal arrangements in the light of the Directive's provisions.

3.1. Statistics and transparency

3.1.1. General considerations

The sovereign debt crisis highlighted a number of lessons as regards statistics and transparency. In the run-up to the crisis, government deficit and debt ratios increased rapidly in a number of Member States, partly due to the materialisation of implicit and contingent liabilities stemming from the financial sector, triggered by the economic downturn. In some cases, these increases only became apparent with the publication of annual data. These developments coincided with the revelation of the true scale of Greece's government deficit. A number of conclusions were drawn from these events; in particular:

- it may not be sufficient to focus attention only on fiscal-surveillance-relevant deficit and debt ratios, as reported to Eurostat in the context of the Excessive Deficit Procedure (EDP) statistics (where data become available with a lag), to understand underlying fiscal trends or take account of hidden liabilities;
- to ensure fiscal discipline, Member States' budgetary frameworks need to cover domestic public finances comprehensively, which requires *inter alia* planning and reporting systems that ensure comprehensive and consistent coverage of all sub-sectors of general government; and
- concentrating control mechanisms solely on outturn data, as reported to Eurostat, may not suffice, so appropriate safeguards are needed to ensure the quality and reliability of input data.

Directive 2011/85 aimed to fill those gaps by addressing areas not directly covered by EU requirements at the time. Specifically, it laid down requirements on public accounting, high-frequency fiscal data and the transparency of general government finances (in particular as regards extra-budgetary units and funds, contingent liabilities and tax expenditures).

Directive 2011/85 targets having in place public accounting systems that cover comprehensively and consistently all sub-sectors of general government and are

subject to internal control and independent audits; the benefits of such systems go beyond statistics. The provisions of Directive 2011/85 in that area are two-fold:

- they clearly link public accounting requirements to ensuring the quality of ESA/EDP⁹ data, which are crucial for the proper functioning of the EU's fiscal surveillance framework, by stressing the need for comprehensive and consistent reporting systems covering all sub-sectors of general government; and
- Directive 2011/85 recognises the specific value of public accounting systems beyond producing statistical data, *inter alia* by referencing the main international standard in this area and by stating that public accounting systems include elements such as bookkeeping, internal control, financial reporting, and auditing, which are distinct from statistical data.

As timely budgetary monitoring necessitates the availability of comprehensive high-frequency data shortly after the end of the reporting period, Directive 2011/85 requires that such data be published for all sub-sectors of general government. The main objective here was to enhance timely budgetary monitoring and to avoid the late detection of significant budgetary errors (see recital 7). To this end, Directive 2011/85 introduced an obligation to publish, with a short lag, cash-based (or equivalent) data on which the subsequent ESA/EDP reporting is based, along with methodological explanations of how the data are used to produce statistics according to ESA standard in the form of a detailed reconciliation table. The particular focus of Directive 2011/85 was to ensure that data are published for all sub-sectors of general government, as defined in the ESA, and not only for the units covered by regular budgets and therefore subject to monitoring by the budgetary authorities.

The reporting requirements in Directive 2011/85 aim to strike the right balance between the timeliness and the comprehensiveness of the data. EU budgetary surveillance is based on fiscal data compiled in line with the requirements in ESA 2010, which is an EU Regulation determining very precisely the content and format of the data. By contrast, national budgetary reporting is based on national traditions and principles, and may therefore differ significantly from ESA-based data, in particular as regards:

- the perimeter of general government sector, where national accounts are based on economic substance rather than legal form, therefore usually capturing some of the extra-budgetary units and corporations not covered by national budgets; and
- the time of recording and accounting basis – while ESA 2010 recording is accruals-based (i.e. it captures the moment of underlying activity), national budgetary reporting is predominantly linked to the timing of cash payments or appropriations.

However, the main advantage of the national budgetary reporting lies in its timeliness. Directive 2011/85 combines these two aspects, requiring monthly publication (quarterly

⁹ Protocol (No 12) on the excessive deficit procedure (EDP) annexed to the Treaty on the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU) provides that EDP deficit means net borrowing as defined in the European system of national accounts (ESA). At the same time, EDP debt means total gross debt at nominal value outstanding at the end of the year and consolidated between and within the sectors of general government. For the purposes of this section, surveillance-relevant ratios of deficit and debt are referred to as 'ESA/EDP data'.

for local government) that is aligned with ESA requirements only in terms of the general government perimeter, while providing an improved timeliness. In addition to high-frequency data based on national approaches, Article 4(7) of Directive 2011/85 also mandated Eurostat to publish quarterly deficit and debt data every three months.

A dedicated statistical task force further specified the requirements in Directive 2011/85 for national cash-based (or equivalent) data publication. The objective was to assist Member States with the practicalities of complying with Directive 2011/85 as regards reporting fiscal data. The task force was led by the Commission (Eurostat in cooperation with the Directorate-General for Economic and Financial Affairs) and was composed of experts in the area of budgetary statistics. It produced a report that was endorsed by the Economic and Financial Committee in February 2013. Without altering the minimum requirements of Directive 2011/85, the report advocated the publication of more detailed breakdowns on the basis of an indicative split by economic categories (e.g. types of tax and major expenditure groups). With respect to the reconciliation table required by Article 3(2), the task force clarified that it should enable non-statisticians to understand better the conceptual differences and the transition between the monthly data used for national policy purposes and ESA data used for national accounts.

Directive 2011/85 requires the publication of information on extra-budgetary bodies and funds, which is needed to ensure better fiscal planning and strengthen democratic control over public finances. As explained above with respect to high-frequency data, in most cases the general government perimeter for ESA/EDP purposes is broader than the perimeter of institutions covered by national budgets. This is because national accounts classify units according to their economic substance rather than formal criteria; over the years, the EU statistical system has developed a comprehensive set of criteria that help to establish the nature of units and of their operations.¹⁰ In order to reduce the chances of *ex post* ‘negative surprises’, Directive 2011/85 also addressed the issue of units classified under general government for the purposes of national accounts, but not covered by regular budgets at sub-sector level. The operations and liabilities of such units affect ESA/EDP deficit and debt outcomes, but they will not necessarily be included at the planning stage, thus creating a risk of deficit and debt overruns *vis-à-vis* targets in medium-term or annual budgetary documentation. Moreover, a lack of transparency with respect to such units limits the ability of parliaments and the public to exercise effective oversight of public sector policies when they go beyond formal budgetary provisions. Accordingly, Directive 2011/85 introduced an obligation to present the combined impact of extra-budgetary units and funds on general government balances and debt in the framework of annual budgetary processes and medium-term budgetary plans.

Directive 2011/85 emphasised the importance of publishing information on contingent liabilities and laid down specific requirements in that respect. Contingent liabilities are potential liabilities that could become actual government liabilities if specific conditions prevail. The timely availability of comprehensive information on them helps policy-makers understand and possibly mitigate the extent of risks associated with the build-up of governments’ explicit and implicit obligations. Since the materialisation of such obligations as government deficit and debt is contingent on uncertain future events, they are not recorded in core national accounts and do not affect

¹⁰ Examples of ‘reclassified’ bodies may include extra-budgetary funds, hospitals, universities, broadcasting corporations, railways, ‘bad banks’, etc.

government deficit and debt. The probability of their materialisation is low in good economic times, but likely to increase in the downturn phase. As with extra-budgetary general government units, accessing information on the extent of such liabilities is partly a matter of ensuring the ability of parliaments and the public to exercise effective oversight of all public sector policies, not only of items formally covered by budgets. Accordingly, Directive 2011/85 introduced some requirements in this area, which the task force developed at technical level. This resulted in:

- common definitions in terms of national accounts, so that comparable data are compiled across Member States; and
- agreement that information on contingent liabilities should be submitted annually to Eurostat, which publishes the data in its database.¹¹

The Directive requires Member States to publish information on tax expenditures, which helps to improve fiscal planning and inform the public debate. Tax expenditures may have a significant impact on the economy and public finances. Timely and detailed data on the expected impact of existing and planned tax expenditures not only make it much easier to identify areas in which the current tax system could be improved, but also improve annual and medium-term fiscal planning. Consequently, it was felt appropriate to include in the Directive a requirement to publish detailed information on the impact of tax expenditures on revenues. However, unlike other provisions covered in this section, that general requirement was not further specified by means of a detailed template, although the Commission did issue a guidance note¹² that provided Member States with recommendations as regards the coverage and level of detail of the tax expenditure information.

3.1.2. Main developments

The analysis below gives an overview of the transposition and implementation, and other developments relating to the statistics, accounting and transparency provisions of Directive 2011/85.

Public accounting

Directive 2011/85 underlines the need for comprehensive and consistent reporting systems that are subject to internal control and independent audits. In particular, Article 3(1) provides that ‘Member States shall have in place public accounting systems comprehensively and consistently covering all sub-sectors of general government and containing the information needed to generate accrual data with a view to preparing data based on the ESA standard. Those public accounting systems shall be subject to internal control and independent audits’. The consistency and comprehensiveness of such systems is also stressed in the second part of Article 12, which requires the ‘consistency of accounting rules and procedures, and the integrity of their underlying data collection and processing systems’. Given the need for a benchmark for assessing the consistency and

¹¹ For more information, see: <https://ec.europa.eu/eurostat/web/government-finance-statistics/contingent-liabilities>

¹² Note to the Economic Policy Committee, July 2013.

comprehensiveness of public accounting systems, Article 16(3) tasked the Commission with assessing the suitability of the International Public Sector Accounting Standards (IPSASs) for the Member States.

The credibility of EU budgetary surveillance hinges crucially on reliable budgetary and financial reporting, which explains why so much effort has been made in this area. Given the importance of ESA/EDP statistics for the proper functioning of the EU fiscal framework, the public accounting provisions in Directive 2011/85 are explicitly linked to the ability to generate accrual data with a view to preparing data based on the ESA/EDP standard. EDP statistics were well regulated even before the crisis and other legal acts affecting their production were adopted at around the same time as Directive 2011/85, in particular:

- Regulation (EU) No 679/2010 amending Regulation (EC) No 479/2009 as regards the quality of statistical data in the context of the EDP, which entitled Eurostat, in the context of methodological visits to Member States, to have access to the accounts of general government entities; and
- Regulation (EU) No 1173/2011 on the effective enforcement of budgetary surveillance in the euro area, which introduced sanctions for the manipulation of statistics.

Thanks to these efforts, the quality of EDP deficit and debt data has improved considerably in recent years. The strengthening of the legal framework supporting the production of EDP statistics led to considerable improvements in the area, as outlined in the Commission's (Eurostat's) annual reports on the quality of EDP data to the European Parliament and the Council (e.g. European Commission, 2019b). Member States' production of EDP statistics is subject to close scrutiny by Eurostat, which makes periodical visits¹³ and issues country-specific advice on request by national statistical offices.¹⁴ When Eurostat has doubts as to the correct application of the rules, it can issue a reservation on EDP deficit or debt data reported by a Member State, or amend the data. However, these interrelated developments make it more difficult to separate the impact of Directive 2011/85 from other developments in this field.

The auditing of public accounts is extensively regulated in all Member States, with approaches varying depending on the specificities of the sub-sectors of government or individual units. Most Member States have very comprehensive legislation regulating production, and internal and external audit of the public accounts, with national supreme audit offices playing a key role as independent external auditors. Budgetary units of central government are predominantly subject to auditing by national courts of auditors, national audit offices or equivalent supreme audit institutions (SAIs). Regional courts of audit and audit offices are also important in countries with sub-national levels of administration. In some Member States, local governments and/or social security funds are audited by certified private audit firms, sometimes on behalf of the national SAI and with auditors chosen through public procurement procedures. It is more common to charge certified private auditors with the auditing of public companies

¹³ For more information on such visits, see:
<https://ec.europa.eu/eurostat/web/government-finance-statistics/excessive-deficit-procedure/eurostat-edp-visits-to-member-states>

¹⁴ For more information on country-specific advice, see:
<https://ec.europa.eu/eurostat/web/government-finance-statistics/methodology/advice-to-member-states>

that are included under general government for national accounts purposes. Directive 2011/85 recognises that this division of responsibilities between SAIs and certified private auditors is at the discretion of the Member States and it is often influenced in practice by factors such as company size, degree of government ownership, state financing and legal form, with SAIs frequently having specific rights with respect to such entities. In some Member States, SAIs are ultimately responsible for auditing all units classified under general government or, even more broadly, all public sector units.¹⁵ With respect to internal control, the situation is even more diverse, as Member States have different approaches to the degree of centralisation and how this function is implemented in practice. All Member States have arrangements for internal control and independent audits of public accounts; these generally differ according to sub-sector and the specificity of the unit in question.

The impact of Directive 2011/85 is clearly visible when it comes to public sector accounting as such, where it has prompted work on a common set of accounting standards. As mentioned above, the Commission was tasked with assessing, by 31 December 2012, the suitability of the IPSASs for the Member States. In response, it produced a report to the European Parliament and the Council, *Towards implementing harmonised public sector accounting standards in Member States: the suitability of IPSAS for the Member States*.¹⁶ It found that governance, conceptual and technical issues meant that the IPSASs at the time were not suitable for direct implementation in the Member States.¹⁷ It also made the case for developing European public sector accounting standards (EPSASs), using the IPSASs as a reference, and concluded that '[t]he Commission will further develop the strategy outlined in this report, taking into account resource constraints, in line with its responsibilities under the Treaties'. In 2013, the Commission launched work on EPSASs geared to improving the transparency and comparability of financial reporting through the introduction of harmonised accruals-based public sector accounting in the EU. The main benefit would be a firmer basis for understanding the financial position and performance of public sector entities at all levels. This has the potential to improve evidence-based decision-making and accountability at EU, national and sub-national levels. In addition, it would enhance the integration and efficiency of capital markets, the analysis of public finances and also provide more efficient ways of producing statistics and addressing potential risks.

The work on EPSAS is currently proceeding in two phases:

- (i) increasing fiscal transparency in the short to medium term by encouraging and supporting accruals reforms in the Member States, while in parallel developing a draft EPSAS framework (Phase 1), with a view to
- (ii) addressing comparability within and between Member States in the context of the EPSAS initiative (Phase 2).

¹⁵ The Member States' different approaches as regards auditing standards and scope, and accounting and reporting standards have been detailed in a study carried out on behalf of the Commission: <https://ec.europa.eu/eurostat/documents/1015035/4261806/study-on-public-accounting-and-auditing-2012.pdf>

¹⁶ <https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2013:0114:FIN:EN:PDF>

¹⁷ Since the 2013 IPSAS report, IPSAS has developed further, addressing in particular the concerns that the Commission had expressed on its governance and the lack of a conceptual framework, and making progress on many technical public-sector-specific accounting issues.

Following the adoption of the IPSAS report, the services of the Commission have continued their work on EPSAS. The progress has been summarised in a dedicated Commission Staff Working Document¹⁸ published in June 2019. The Staff Working Document showed how the issues identified in the IPSAS report have been addressed. It concluded that during Phase 1, the readiness of the Member States to implement accrual accounting in their public sector has increased, while significant progress had also been made on the necessary technical preparations for taking the project forward. There is growing acknowledgment of the benefits of accrual accounting for government entities in the Member States, and of comparable financial accounting and reporting practices. The EPSAS work has involved in particular:

- engaging in systematic communication with policy-makers, governments, auditors, accountancy experts, academics and other stakeholders;
- setting-up an EPSAS working group involving Member State experts representing all levels of government and the key EU and global stakeholders;¹⁹
- issuing guidance for the first-time implementation of accruals accounting by public sector entities, developing the EPSAS conceptual framework and analysing key public sector specific accounting issues;
- collecting the evidence base for a future impact assessment; and
- in cooperation with the Commission's Structural Reform Support Service, providing financial support in the form of grants and technical assistance to beneficiaries conducting national public sector accounting reforms.

The Council has issued several conclusions on public sector accounting since the adoption of the IPSAS report. In particular, it has encouraged the Commission to engage actively various stakeholders and provide the Member States with technical and financial support. It has concluded that the work on EPSAS should be informed by a detailed impact assessment.²⁰ In 2019, the Council recognised the progress made in this area.²¹ The European Parliament also noted the ongoing efforts to enhance the transparency and comparability of public accounts by developing EPSAS.²²

The EPSAS-related work has already brought tangible benefits for the Member States and had positive spillovers beyond the EU. The Commission's approach has had direct and indirect effects, such as supporting IPSAS development work and informing debates on government accounting reforms in a number of Member States. In recent years, around a third of the Member States²³ have reported reforms, either to improve their existing accrual accounting and associated (e.g. budgeting) systems or to

¹⁸ https://ec.europa.eu/eurostat/documents/9101903/9823491/EPSAS_Progress_Report_2019.pdf

¹⁹ For related documents, see: <https://ec.europa.eu/eurostat/web/epsas/expert-groups>

²⁰ <http://data.consilium.europa.eu/doc/document/ST-14011-2017-INIT/en/pdf>. By way of preparation, Eurostat has already commissioned a series of studies, including, for example, a 2014 study on the potential impacts of implementing accrual accounting and analysis on IPSAS standards:

²¹ <https://ec.europa.eu/eurostat/documents/1015035/4261806/EPSAS-study-final-PwC-report.pdf>

²² <https://data.consilium.europa.eu/doc/document/ST-13962-2019-INIT/en/pdf>

²³ https://www.europarl.europa.eu/doceo/document/TA-8-2016-0248_EN.pdf

²³ Bulgaria, Czechia, Denmark, Estonia, Finland, some of the German *Bundesländer* (e.g. Hamburg and North Rhine-Westphalia), Hungary, Italy, Latvia, Poland, Slovenia and Spain.

implement accrual accounting. Almost all Member States considered as having less advanced government accounting have either started to modernise their public sector accounting systems (e.g. Cyprus, Malta) or are preparing to do so (e.g. Greece, Luxembourg). More recently, Ireland has also taken steps to modernise its public sector accounting. Such reforms correspond to the aim of Article 3(1) of Directive 2011/85 insofar as they transform cash-based, mixed or otherwise fragmented public accounting systems to deliver complete, coherent and harmonised accruals-based public accounting systems. The Commission's efforts in this area are also compatible with the work of the IMF, the OECD and the World Bank on public sector accounting reform, and go in the same direction as public accounting reforms elsewhere in the world.

Stakeholders consider the lack of a single EU public accounting standard and the lack of common national standards as the main difficulties in implementing Directive 2011/85. The Commission surveyed the finance ministries, who in most cases set the national standards and prepare the accounts. The respondents to the survey reported some difficulties with the implementation of the provisions in Articles 3(1) and 12. While fewer than half of respondents experienced no, or only minor, difficulties, about a third considered the provision to be rather difficult to implement and around a quarter experienced some difficulties. Among those experiencing difficulties, the main reason given was the lack of a single public sector accounting standard in the EU, followed by the lack of single public sector accounting standard at national level. Among other reasons, a few respondents also referred to insufficient clarity with respect to the definition of public accounting systems in Directive 2011/85. Nevertheless, a clear majority of the finance ministries that responded assessed the consistency of their own accounting rules and the integrity of data collection and processing systems in their countries as 'high' or 'very high', with only a minority assessing this as 'average'.

High-frequency fiscal data

Directive 2011/85 requires the publication of data for all sub-sectors of general government, while allowing flexibility with respect to the accounting basis. In particular:

- Article 3(2) requires the Member States to ensure:
 - the timely and regular public availability of cash-based fiscal data (or equivalent figures from public accounting) for all sub-sectors of general government, in particular:
 - monthly data for central government, state government and social security funds, before the end of the following month; and
 - quarterly data for local governments, before the end of the following quarter.
 - publication of a detailed reconciliation table showing the methodology of transition between cash-based (or equivalent) data and data based on the ESA standard; and
- Article 4(7) requires the Commission (Eurostat) to publish Member States' quarterly deficit and debt levels every three months.

Directive 2011/85 established a reporting system that removes the differences between national budgetary reporting and ESA with respect to the perimeter of general government. As discussed in Section 3.1.1, national budgetary data and fiscal outcomes based on ESA/EDP principles could differ significantly. If not properly monitored or taken into account, these differences constitute a source of fiscal risk. Ideally, high-frequency (monthly and quarterly) monitoring should be based fully on ESA principles to rule out deviations from fiscal targets expressed in terms of ESA/EDP deficit and debt, or ensure that deviations are corrected promptly when they occur. However, a number of Member States considered such a requirement disproportionately burdensome at the time the Directive was being discussed. As a result, the requirements in Directive 2011/85 seek to ensure that one of the two major sources of divergence (the perimeter of general government) is removed in the national high-frequency publications. As further explained in recital 7, it is possible to rely, where justified, on suitable estimation techniques based on a sample of bodies when compiling the data, with a subsequent revision using complete data. At the same time, the published data are in most (but not all) cases cash-based, differently from ESA/EDP reporting, which is based on accrual principle. Directive 2011/85 also allowed Member States to use equivalent figures from public accounting if cash data were not available; a minority of Member States made use of this possibility by publishing accrual or mixed cash/accrual data. Using accrual input data could further reduce differences between data required by Directive 2011/85 and ESA/EDP outcomes, while such differences can be comprehensively explained by means of statistical accrual adjustment. Nevertheless, in some circumstances the availability of cash data may bring an additional advantage in terms of signalling possible liquidity problems in times of market distress.

More than half the Member States have specific legal provisions to back the publication of high-frequency data. Among the Member States that have introduced such provisions, a majority did so in laws regulating the budgetary area; a minority introduced such requirements in ministerial decrees and circulars. The remaining Member States did not introduce explicit legal provisions on publishing the data.

Overall, the publication requirements are well implemented in the Member States. All Member States publish the high-frequency data, although in a few cases coverage seems to be incomplete and data may be published with delays. In most, the data are published on the finance ministry website, in around a third on the website of the national statistical office and, in a few cases, on the websites of the treasury or specialised budgetary offices. While Eurostat tries to keep the list of websites²⁴ up to date, Member States sometimes fail to notify changes promptly, resulting in obsolete links.

Directive 2011/85 aimed to reduce gaps in data availability. Its requirements were partly a response to the uneven data availability observed across the EU, with timely public reporting on budgetary execution still very limited in many Member States at the time of its adoption. In recent years the budgetary authorities in a number of countries have made considerable efforts to improve overall transparency and facilitate accountability, in particular by publishing high-frequency analytical reports. While such reports are now published in most Member States, they often follow national budgetary definitions.

²⁴ <https://ec.europa.eu/eurostat/documents/1015035/8610964/Listing-of-national-websites.pdf>

The visibility of data published in accordance with Directive 2011/85 is sometimes low, with the domestic debate focusing on national budgetary concepts. The initial differences in transparency with respect to budgetary reporting also resulted in differences in the implementation of Directive 2011/85. In a few Member States in which the public reporting systems were created or substantially redesigned after the adoption of Directive 2011/85, publications have filled the gap and are better known to the public and media. However, in many Member States that had well-known national budgetary publications previously, publications to comply with Directive 2011/85 were sometimes created as a separate reporting exercise and are considerably less known, as a rule. Moreover, very few of such publications attempt to explain in a comprehensive manner the differences between the national publication and ESA concepts. This may have affected the visibility of data: close to half of the publishing authorities assess the data to be of some interest to users, while one-third assess the interest as limited; only in a minority of Member States the publishing authorities assess that data are of great interest to users.

Another reason for differences in the degree of public awareness may lie in the level of detail of published data. As mentioned above, the requirements in Directive 2011/85 were developed in more detail in the report from the task force. While the report did not alter the minimum requirements (publication of at least an overall balance, total revenue and total expenditure), it encouraged Member States to publish more detailed breakdowns by providing an indicative split by economic categories. However, in practice around a third of the Member States restrict the information made available to the minimum required by Directive 2011/85 (i.e. total revenue, total expenditure and balance of each sub-sector), while two thirds provide additional information. However, the level of detail varies considerably across countries. Where more detailed data are available, the publishing institutions tend to assess the degree of interest in the data to be higher, but this is not always the case and there are notable exceptions.

High-frequency data are sometimes considered a source of disproportionate administrative burden, despite the possibility of using estimates. Some surveyed stakeholders argued that the data requirements constitute a disproportionate administrative burden in return for uncertain benefits for users. It is worth noting that, according to recital 7 of Directive 2011/85, where justified, timely publication of data could rely on suitable estimation techniques. A large majority of Member States use such estimates to various degrees, typically to cover small public bodies and less significant extra-budgetary funds, where only annual source data may be available. Only a few Member States do not use estimates, usually relying on comprehensive public sector accounting systems for input data. Using estimates can reduce administrative burden and be a second-best means of ensuring comprehensiveness.

All Member States publish a detailed reconciliation table showing the methodology of transition between cash-based (or equivalent) data and data based on the ESA standard, with some differences in terms of approach and level of detail. As discussed above, the usefulness of data depends largely on users' ability to relate it to other reported outcomes — national budgetary execution, on the one hand, and ESA/EDP deficit, on the other. To clarify the nature of Article 3(2) of Directive 2011/85 and encourage consistency in the presentation of the reconciliation tables, the task force agreed on an indicative flowchart of the information to be provided. While all Member States publish some form of reconciliation table, the approaches and level of detail vary

significantly. By far the majority base the reconciliation table on the flowchart agreed by the task force.

In addition to high-frequency data according to national definitions, Eurostat publishes quarterly deficit and debt data for all Member States according to the ESA/EDP standard. In recent years, Eurostat has significantly expanded the range of integrated quarterly data on government finance statistics, providing a timely and increasingly high quality picture of developments concerning government finances in the EU. Since the adoption of Directive 2011/85, Eurostat has increased significantly the level of validation checks performed, aiming to ensure the correct statistical recording of major transactions from the first quarterly transmission onwards and thereby make the data more relevant for users. Eurostat publishes quarterly (non-financial) data for all main ESA categories of government revenue and expenditure, and there is a separate quarterly publication on quarterly EDP debt by instrument and sub-sector. With respect to quarterly data on deficit and debt according to the ESA/EDP standard, as required by Directive 2011/85, Eurostat releases the data gradually up to around t+113 days after the end of the reference quarter.²⁵ Eurostat had already published quarterly government debt data for all Member States before the adoption of Directive 2011/85, and a dedicated press release since 2012. Since April 2014, Eurostat has also published quarterly press releases with respect to general government deficit / surplus²⁶ (as well as detailed non-financial and financial accounts) for all Member States. Since October 2014, Eurostat has collected quarterly non-financial data by sub-sector of general government. Currently, about half the Member States provide quarterly government revenue, expenditure as well as its breakdowns by sub-sector of general government. Similarly, Eurostat has collected seasonally adjusted data on the quarterly deficit / surplus since 2013 and has published a dedicated press release since February 2014. The press release with seasonally adjusted data²⁷ for EU and euro area aggregates is complemented by a Statistics Explained page²⁸ including seasonally and non-seasonally adjusted data for the Member States. Since April 2016, the press release has also highlighted country data. More Member States now provide seasonally and working day adjusted data, bringing the total number of them to 25.

Directive 2011/85 requires Eurostat to publish quarterly data, while data collection is based on more fragmented requirements, and some data are collected on the basis of a ‘gentlemen’s agreement’. Article 4(7) of Directive 2011/85 obliges Eurostat to publish quarterly deficit and debt levels every three months. However, the corresponding obligation for the Member States to report the data is more fragmented. Eurostat makes

²⁵ Quarterly data are published in Eurostat’s database (dataset gov_10q_ggnfa for non-financial accounts including deficit and gov_10q_ggdebt for debt). Also, press releases accompany publication of seasonally adjusted quarterly deficit data (e.g. <https://ec.europa.eu/eurostat/documents/2995521/10064379/2-22102019-BP-EN>) and quarterly debt data (e.g. <https://ec.europa.eu/eurostat/documents/2995521/10064364/2-22102019-AP-EN>).

²⁶ In the press release: non-seasonally adjusted data since July 2018 and seasonally and calendar adjusted since April 2014.

²⁷ Including non-seasonally adjusted data since July 2018.

²⁸ https://ec.europa.eu/eurostat/statistics-explained/index.php/Government_finance_statistics_-_quarterly_data

use of obligations laid down in Regulation No 1221/2002²⁹, as well as obligations in the ESA 2010 Transmission Programme. However, those requirements do not fully cover the range of collected data, notably sub-sector breakdowns and seasonally adjusted data, and there are differences with respect to reporting standards and deadlines. Consequently, Eurostat collects some of that data on a voluntary basis under a ‘gentlemen’s agreement’, which may have practical implications in terms of availability of resources for data compilers.

Transparency with respect to extra-budgetary bodies and funds

Certain public funds, agencies and corporations may affect ESA/EDP deficit and debt without being covered by regular budgets; this is why Directive 2011/85 requires that information on these units and their budgetary impact be made available. An important aspect of avoiding ‘negative surprises’ concerns funds and bodies that are not covered by regular central, regional or local government budgets, but are classified under the general government sector for the purposes of ESA/EDP statistics. Such bodies can affect the fiscal outcomes that are relevant for EU budgetary surveillance and national fiscal rules, while not always being covered by planning documents and associated accountability procedures applicable to budgetary units. Accordingly, Article 14(1) of Directive 2011/85 lays down that ‘[w]ithin the framework of the annual budgetary processes, Member States shall identify and present all general government bodies and funds which do not form part of the regular budgets at sub-sector level, together with other relevant information. The combined impact on general government balances and debts of those general government bodies and funds shall be presented in the framework of the annual budgetary processes and the medium-term budgetary plans’.

Transparency when it comes to identifying the units classified under general government is good overall, but uneven across Member States. The national statistical institutes are responsible for classifying units for statistical purposes, so information related to sector classification usually appears on their websites. A very large majority of Member States make information about general government bodies available to the public, with various approaches: more than half (including some large ones) make available lists where all general government units are identified individually, while a third publish lists grouping some of the smaller homogeneous units (e.g. local municipalities). A few countries maintain business registries that also include sector classification for statistical purposes. Given the importance of this information for the correct implementation of EU requirements in the field of ESA/EDP statistics, Eurostat also publishes lists or overviews of units included in general government on its website as annexes to the EDP inventories.³⁰

²⁹ Regulation (EC) No 1221/2002 of the European Parliament and of the Council of 10 June 2002 on quarterly non-financial accounts for general government, OJ L 179, 9.7.2002

³⁰ EDP inventories describe the methods, procedures and sources used by each Member State to compile actual deficit and debt data and the underlying government accounts. They are available at: <https://ec.europa.eu/eurostat/web/government-finance-statistics/excessive-deficit-procedure/edp-inventories>

The identification and presentation of such extra-budgetary bodies and funds in the budgetary process vary across Member States. Despite the overall high degree of transparency with respect to the lists of units classified under general government, it is possible only in a minority of Member States to distinguish clearly, on the basis of public sources, between general government units that are covered by regular budgets and those that are not. Further progress needs to be made with respect to presenting the combined impact of extra-budgetary bodies and funds on general government balances and debts in the annual budgetary process and in the medium-term budgetary plans: less than half of the Member States explicitly present the combined impact on general government balances and even fewer do so for debt.

Many Member States found Article 14(1) of Directive 2011/85 difficult to implement. This emerged from the stakeholder consultation, where a third of the responding finance ministries considered it ‘very difficult’ or ‘difficult’ to implement, and another third cited ‘moderate’ difficulties. The main reported reasons for difficulties relate to administrative burden on small units, a lack of comprehensive data sources, insufficient quality of input data and the large number of units to be covered.

Transparency with respect to contingent liabilities

Member States are required to publish, for all sub-sectors of general government, relevant information on contingent liabilities with potentially large impacts on public budgets. Article 14(3) provides a non-exhaustive list of types of contingent liability to be reported: ‘(...) including government guarantees, non-performing loans, and liabilities stemming from the operations of public corporations’. Member States are also to publish (as a significant source of fiscal risk and, to a certain extent, an implicit contingent liability) ‘information on the participation of general government in the capital of private and public corporations in respect of economically significant amounts’.

Directive 2011/85 has contributed to major progress in the reporting of data on contingent liabilities. In addition to the publication at national level, the statistical task force agreed that Eurostat should also collect and publish the above information (with the exception of general government participation in corporations, which remains a nationally published dataset), while adding to the list in Directive 2011/85 liabilities stemming from off-balance public-private partnerships (PPPs). As a result, since 2015 Eurostat has published series of contingent liabilities indicators covering a period from 2010 onwards, which is an important step forward as regards the transparency of fiscal risks. More generally, Member States have taken the lead in developing these data in line with Directive 2011/85 and the current availability, coverage and data collection methodologies are advanced compared to other countries’.

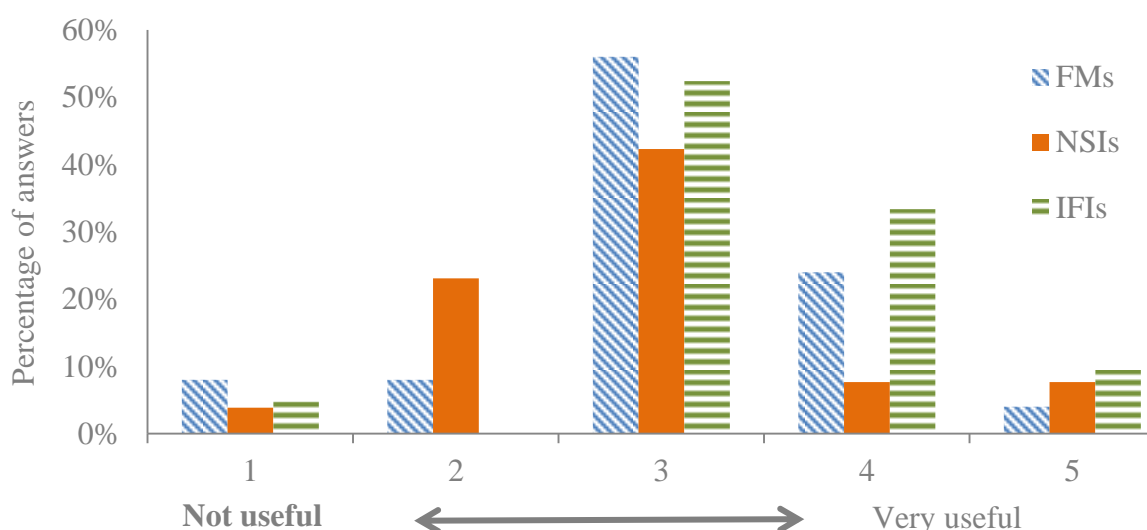
The completeness and coverage of data submitted to Eurostat vary across Member States and by component of contingent liability. As reported by Eurostat with regard to the 2018 data submission (with data coverage up to and including 2017),³¹ data completeness and coverage are high for government guarantees, although for local

³¹ <https://ec.europa.eu/eurostat/en/web/products-press-releases/-/2-30012019-AP>

government guarantees data are still not available in few Member States and incomplete in few others. As with guarantees, data completeness and coverage are good for off-balance PPPs, with some shortcomings for local governments in a few cases. Information on non-performing loans (NPLs) still needs improvement, as data are missing for some Member States, while in several others data coverage is not exhaustive. As regards the submission of data on liabilities of government-controlled entities classified outside general government, in a few Member States data coverage is not exhaustive for local governments or for minor units.

The comparability of data across Member States is generally good, but some important aspects need to be borne in mind. Comparability is particularly good for government guarantees, NPLs and off-balance PPPs. For liabilities of public corporations, there are some differences in data reporting, notably arising from the accounting concepts used (some countries report business liabilities and others the ‘Maastricht’ liabilities). Nevertheless, Member States report significantly different levels of public corporations’ liabilities, because some have more entities controlled by general government and involved in financial services than others. Those countries report higher liabilities than those with few or no such entities. For Member States with a higher proportion of government-controlled financial institutions, many of the liabilities reported by financial institutions concern deposits held in public banks by households or by other private or public entities. In general, financial institutions report high amounts of debt liabilities; however, they also have significant assets that are not captured in the data collection. Another important aspect to be kept in mind is that the same fiscal risk might be reflected in two or more contingent liability indicators, e.g. if a government guarantees the liability of a public corporation, the potential risks are covered by data presented both for ‘guarantees’ and ‘liabilities of government-controlled entities classified outside general government’. Therefore, evaluating the total risk by adding up the indicators could overestimate the potential impact.

Graph 3.1.2: Usefulness of comparable EU data on contingent liabilities (stakeholders’ views)



Source: Stakeholders survey

The publication of information on contingent liabilities at national level, as required by Directive 2011/85, has also largely improved. All Member States except France and

Greece currently publish that information nationally. As agreed by the task force, all indicators required by Directive 2011/85 should be published on a single dedicated national webpage. All publishing countries follow this guidance and provide the data on a dedicated webpage of the finance ministry or the national statistical institute.³² Almost all provide data nationally for all the indicators, while indicators on NPLs are still missing in a few. In some cases, national publication does not follow the task force guidelines, which specify the methodology and templates to be used. For a handful of Member States, there are (non-significant) discrepancies between the data published nationally and data published by Eurostat.

Member State practitioners broadly concur on the usefulness of reporting contingent liabilities. Most stakeholders consider the publication of the EU database on contingent liabilities as broadly useful for understanding fiscal risks in the Member States and deem the list of contingent liabilities to be adequate (see Graph 3.1.2). Suggestions for improvements, put forward mostly (but not only) by IFIs, include adding the potential impact of court decisions and pension liabilities, and, to a lesser extent, adding commitments related to euro area stability arrangements, implicit guarantees to the financial sector and callable capital of international organisations. In some cases, stakeholders would welcome more detailed information, e.g. for guarantees, off-balance PPPs (risk allocation) and NPLs (reporting separately data related to defeasance structures). National statistical institutes found more frequently that data on liabilities of financial public corporations should be published either net of assets or together with data on assets.

Transparency with respect to tax expenditures

Article 14(2) of Directive 2011/85 requires the Member States to publish detailed information on the impact of tax expenditures on revenues, but the meaning of ‘detailed’ is not specified. To promote a comprehensive and cross-country consistent approach to this requirement, a Commission note discussed at the Economic Policy Committee proposed guidelines as to what information on the impact of tax expenditures would most usefully serve the objectives of the Directive. The main recommendations in that note included:

- reporting on both existing and planned tax expenditures, coverage of the whole general government, time span covering at least two years (including the most recent year for which data are available and an estimate for the following year);
- presenting the impact in monetary terms; and
- providing a description of the main assumptions used for the definition and calculation of tax expenditures.

While making available information on tax expenditures is a legal requirement in the vast majority of Member States, practices vary significantly. In the absence of content indications in the Directive or of a harmonised template or procedure, divergent practices lead to uneven transparency and usefulness for budgeting and fiscal planning

³² A list of the national websites is available at:
<https://ec.europa.eu/eurostat/documents/1015035/9532280/Listing-of-national-websites.pdf>

purposes, thus preventing cross-country comparisons. Specifically, differences have emerged in terms of content, granularity, frequency of publication and the type of document in which the information is made public.

The different approaches to tax expenditure transparency are most visible when it comes to the published content. Fewer than half the Member States publish information on both existing and new or planned tax expenditures, while the remaining publishing countries do so only for existing tax expenditures. The number of Member States whose reporting covers the whole of general government is particularly low, making up only a third. All Member States that publish the impact of tax expenditures do so in monetary terms, while over half make the underlying assumptions and methodologies available to the public. The categorisation of the tax expenditures is also diverse, the most widely used being by tax base (the vast majority of reports) and by purpose (about half). Three quarters of the Member States use more than one categorisation in their publications.

An annual publication is the most common in terms of frequency. About three quarters of the Member States present information on tax expenditures annually, while others report less regularly.

Table 3.1. Publication of information on tax expenditures in Member States

Country	Regular publications*	Time coverage**
BE	X	t-7, t-6, t-5, t-4, t-3, t-2
BG	X	t-2
CY	X	t
CZ		t-6, t-5
DK	X	t-1
DE	X	t-2, t-1, t, t+1
EE	X	t, t+1
IE	X	t-1, t
EL	X	t-2
ES	X	t, t+1
FR	X	t-1, t, t+1
IT	X	t+1, t+2, t+3
NL	X	t-5, t-4, t-3, t-2, t-1, t
AT	X	t-2, t-1, t, t+1
PT	X	t+1
SK	X	t-2, t-1, t, t+1, t+2, t+3
FI	X	t-1, t, t+1
LV	X	t-3, t-2, t-1
LU	X	t
LT	X	t+1
RO	X	t-1, t, t+1, t+2
HU	X	t+1
PL	X	t-3
SE	X	t-1, t, t+1, t+2
UK	X	t-4, t-3, t-2, t-1, t

Notes: The information reported refers to the 2018 edition of tax expenditure reports.

* Regular reporting generally refers to an annual frequency; the exceptions are Germany (update every 2 years) and Denmark (where only the new tax expenditures and changes to existing ones are updated annually).

** Year t denotes the year of publication.

Source: Commission services based on national sources.

A particularly pertinent aspect for fiscal planning is the publication of forward-looking information in order to estimate the medium-term impact of tax expenditures, both those in place and planned. Only about half the Member States present estimates for future years and in most cases the information made available covers only the very near future (year t+1 and in a few cases t+2). In terms of publishing forward-looking information that benefits medium-term fiscal planning the most, the Netherlands (although only until 2016) and Slovakia can be highlighted as examples of best practice, as they cover the past impact of tax expenditures since year t-2 and provide estimates for the whole medium-term horizon (until year t+3 for Slovakia and t+4 for the Netherlands). As of 2017, however, the latter only publishes backward-looking information.

The information on the impact of tax expenditures is mostly published as part of the annual budgetary processes, but in a few cases it is published in a standalone document. Over half the Member States chose to incorporate it in national budgetary documents, be it in the annual budget or the medium-term plans. A third publish standalone documents and a few make the information public in a different format on the finance ministry's website.

3.1.3. Conclusions

In the area of public accounting, Directive 2011/85 has helped improve the quality of ESA/EDP data and given an impetus to developing public sector accounting standards in the EU. Directive 2011/85 aimed to improve the basis for compiling ESA/EDP deficit and debt data, which are crucial for the credibility of the EU surveillance framework, while at the same time stimulating wider use of public sector accounting, recognising its potential to improve the transparency of public finances and efficiency of public financial management. With respect to improving the overall quality of EDP statistics, where the overall legal framework was strengthened considerably in the aftermath of the sovereign debt crisis, the impact of Directive 2011/85 is more difficult to disentangle from other developments in the field of EDP statistics. Overall, data quality has clearly improved and recent public sector accounting reforms in the Member States have probably contributed to that. Nevertheless, in the absence of a common reference standard, sometimes also at national level, as reported by the stakeholders, national public accounting systems remain partially fragmented, thereby limiting the extent to which the aims of Directive 2011/85 in this area were met, as well as the potential efficiency gains. Directive 2011/85 helped kick-start broader work on developing public sector accounting in Europe, which also contributes to the improvement of global standards and governance in this area. In recent years, the readiness of the Member States to implement accrual accounting in their public sector has increased, while there has been significant progress towards developing common EU public sector accounting standards. At the same time, stakeholders consider the lack of common EU public sector accounting standards as one of the difficulties in implementing that element of Directive 2011/85.

All Member States publish high-frequency fiscal data, but practices and data visibility vary. Fiscal data that are published shortly after the end of the reporting period help to ensure that possible deviations from the fiscal targets expressed in terms of ESA/EDP deficit and debt are detected and corrected in a timely manner. However, the level of detail of the published data varies, with some Member States publishing only a

compulsory minimum and some providing more detailed breakdowns. While ideally such high frequency reporting should be based on ESA/EDP standard, Member States considered introducing such a requirement too burdensome at the time of discussing the Directive. The eventually agreed requirement is to publish monthly data for all sub-sectors of general government (except for local governments, for which data should be released quarterly), which are only partly aligned with the requirements of ESA/EDP statistics, with the alignment covering general government perimeter but not necessarily other aspects. On the other hand, the incomplete alignment is compensated by the timeliness of the data. The requirement to publish high-frequency fiscal data certainly helped to improve the transparency of public finances, particularly in countries with low initial levels of budgetary transparency. At the same time, in a number of Member States the users seem to struggle with the definition that lies in-between national budgetary concepts and ESA/EDP, resulting in modest data visibility. The limited level of detail and of explanatory information may have further contributed to this. Some stakeholders have consequently expressed concerns about the administrative burden they associate with the production of the monthly and quarterly data required by Directive 2011/85, against uncertain benefits for the users. Meanwhile, Eurostat's publication of quarterly deficit and debt data based on ESA/EDP concepts has considerably improved in recent years, providing an alternative balance between the timeliness and the quality of information.

There is similar unevenness regarding transparency with respect to extra-budgetary bodies and funds and their impact on deficit and debt across the Member States. As extra-budgetary bodies and funds can affect the ESA/EDP deficit, they may represent a source of fiscal risk when not appropriately identified and taken into account at the planning stage. The majority of Member States publish information about all bodies and funds classified under general government for national accounts purposes, with some providing exhaustive lists and others grouping smaller units. However, in only a few countries is it possible to distinguish clearly between budgetary and extra-budgetary entities. Further progress needs to be made with respect to presenting the combined impact of extra-budgetary bodies on general government balances and debt. The stakeholder consultation also indicated that Article 14(1) was a difficult provision to implement.

In the area of contingent liabilities, Directive 2011/85 resulted in a leap forward with respect to the transparency of associated fiscal risks. Almost all Member States now publish data on main types of contingent liability (government guarantees, off-balance PPPs, NPLs and liabilities stemming from the operations of public corporations), with minor pending issues related to the completeness and comparability of data. As a result, transparency in this area of fiscal risks has significantly increased. Some stakeholders propose further improving transparency by adding more detail to the information already provided, e.g. by including the asset side of the balance sheets of entities controlled by the government or disclosing information on flows related to contingent liabilities, as opposed to only stocks. Other ideas put forward include covering the potential impact of court decisions or liabilities related to the financial sector.

With respect to the impact of tax expenditures, the practice is now well established and the overall level of transparency is good, but the form and content of publications differ across Member States. The general requirement to publish detailed information on the impact of tax expenditures on revenues resulted in a well-established practice in most Member States. Nonetheless, in the absence of more specific

information requirements, the content and form of published information differ significantly across the board, leading to uneven transparency and usefulness for budgeting and fiscal planning purposes, and preventing cross-country comparison. Moreover, since there is no explicit obligation to present estimates of the medium-term impact of tax expenditures, which would be of substantial value for medium-term fiscal planning, most Member States currently publish only backward-looking or current information.

Overall, Directive 2011/85 has clearly contributed to fiscal transparency and helped to improve the quality of statistical information; the most visible progress has been in areas where work to specify the requirements was done at technical level in the statistical task force. While Directive 2011/85 has contributed to improving the quality of statistical information and the transparency of budgetary processes in many areas, the most impressive progress relates to contingent liabilities, where it led to the establishment of a harmonised EU dataset. This was possible thanks to considerable technical work done by the EU statistical community in agreeing and implementing the underlying standards. At the same time, progress has been more limited where no common technical approach was agreed, e.g. in the area of transparency with respect to extra-budgetary units and funds, as well as tax expenditures. Similarly, in the absence of a common EU reference standard on public sector accounting, some national systems remain fragmented. How much Directive 2011/85 contributed to progress in individual Member States depended largely on the initial level of transparency or quality of underlying accounting and reporting systems, but it did help to even up transparency and quality of data across Member States.

3.2. Forecasts

3.2.1. General considerations

Prudent forecasting methods and assumptions are amongst the cornerstones of realistic budgetary planning and, thus, of strong and sustainable public finances. However, putting into practice that conceptual consensus is challenging, and performance varies across Member States and over time. Member States' average forecasting track-record in the pre-crisis era proved to be not so solid. In particular, there was a general trend of over-optimism in preparing both the macroeconomic forecasts underlying fiscal planning and the corresponding budgetary forecasts (Beetsma *et al.*, 2009). That finding inspired recital 8 of Directive 2011/85, according to which '[b]iased and unrealistic macroeconomic and budgetary forecasts can considerably hamper the effectiveness of fiscal planning and consequently impair commitment to budgetary discipline (...)'.

Accordingly, developing appropriate forecasting procedures, methodologies and models is of utmost importance for sound budgetary processes.

Empirical studies show that transparent budgetary processes have a favourable impact on sovereign ratings and debt service costs (see e.g. Kemoe and Zhan, 2018). Fiscal transparency involves facilitating public access to timely, comprehensive and internationally comparable information on budgetary activities, including transparency of the preparation of official macro-fiscal forecasts. In that domain, as highlighted by recital 9 of Directive 2011/85, public availability should not only encompass the regular release of official projections, but the underlying methodological information as well.

Directive 2011/85 recognises the importance of reliable macro-fiscal forecasts in budgetary planning. Specifically, it asserts the guiding principle that ‘Member States shall ensure that fiscal planning is based on realistic macroeconomic and budgetary forecasts’ and accordingly sets certain requirements for the format and content of national forecasting processes underpinning budgetary planning. As forecasts of independent bodies can provide useful benchmarks, Directive 2011/85 requires national authorities to compare their macroeconomic and budgetary forecasts with the latest forecasts of the Commission and, if appropriate, those of other independent bodies. There must be a reasoned description of significant differences between the chosen macro-fiscal scenario and the Commission’s forecast.

The historical context of the proposal for Directive 2011/85³³ motivated the focus on the early identification and management of fiscal risks. To this end, Directive 2011/85 also requires Member States to complement their forecasts with a sensitivity analysis by stipulating that ‘the macroeconomic and budgetary forecasts shall examine paths of main fiscal variables under different assumptions as to growth and interest rates.’

Directive 2011/85 emphasises the importance of transparency and regular evaluation of past performance. It requires the specification of institutional responsibilities for producing macroeconomic and budgetary forecasts and the public release of the macroeconomic and budgetary forecasts prepared for fiscal planning, including ‘the methodologies, assumptions and relevant parameters underpinning those forecasts.’ To improve the quality of the projections and promote accountability, Directive 2011/85 also calls for ‘regular, unbiased and comprehensive evaluation’ of past forecasting performance, including *ex post* evaluations. If such evaluations detect a possible significant bias affecting macroeconomic forecasts over a period of at least four consecutive years, the Member State concerned is required to take the necessary action and make it public.

It is essential to note that the provisions on forecasts in Article 4 of the Directive seek to cover both macroeconomic and budgetary forecasts whenever they are produced for fiscal planning purposes, namely with respect both to annual budgets and medium-term planning documents. In other words, the aim of Directive 2011/85 has been to put in place a set of basic procedures and practices that Member States follow systematically in the production and publication of their forecasts. While the default expectation in the context of Directive 2011/85 is that the outcomes of the key national budgetary documents reflect forecasting requirements, in some cases this can be done, to some extent, via documents prepared for EU fiscal surveillance purposes, i.e. stability and convergence programmes (SCPs) or draft budgetary plans (DBPs) for the euro-area Member States.

Overall, the Directive provisions set out in Article 4 aim to orient the budgetary authorities of the Member States towards basing their fiscal planning on prudent forecasts, without redefining existing national timeframes and institutional responsibilities. In that respect Regulation No 473/2013, which applies to euro-area Member States only, goes much further, most notably by establishing a common budgetary timeline and introducing the obligation for the macroeconomic forecast underlying both draft annual budgets and national medium-term fiscal plans to be either

³³ see Section 2.

produced or endorsed by independent bodies.³⁴ Thereby Regulation No 473/2013, and in particular the independent endorsement requirement, influenced considerably the design of the forecasting procedure in the Member States concerned, and their adherence to the principle of realism. Therefore, in a number of respects, it is very challenging to disentangle the specific impact of the Directive from the influence of other relevant factors.

3.2.2. Main developments

In the area of forecasting, Directive 2011/85 essentially set additional content requirements for the presentation of the macroeconomic and budgetary projections and sought to boost their transparency. Applying the provisions included in Article 4 typically required some fine-tuning of previously existing approaches and procedures, without, however, amounting to a fundamental revamp of the forecasting process. Given the specific and technical nature of the provisions in question, Member States transposed them through a combination of legislative vehicles and other types of measures. While the majority of Member States amended their organic laws on public finances to cater for the transposition of some elements, in several cases legal acts ranking lower in the domestic legal order, or administrative acts, had to be amended (e.g. government or ministerial decrees, budgetary circulars, cooperation agreements), as those were the established vehicles for regulating forecasting issues.

An overview of transposition and implementation developments by the main forecasting provisions of Directive 2011/85 follows hereinafter.

Principle of realism

Member States must adhere to the principle of realism in their budgetary processes. To achieve this objective, Article 4(1) of Directive 2011/85 requires them to base the budgetary planning on the most likely macro-fiscal or on a more prudent scenario. The overwhelming majority of Member States have chosen to codify that principle in their legislation. Compliance with it in practice cannot be measured directly, but it can be proxied by recent empirical studies on the evolution of forecast prudence.

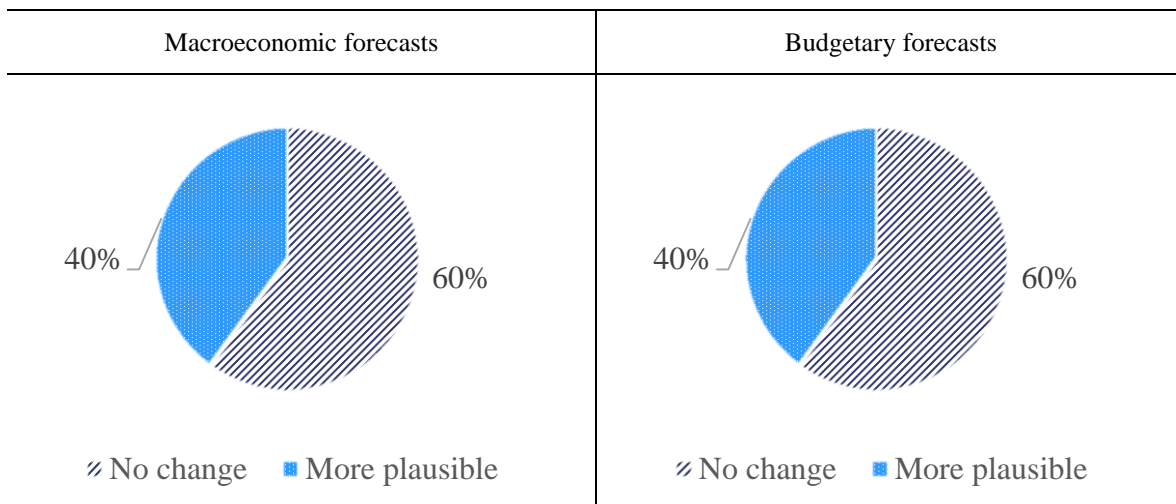
There is some preliminary empirical evidence that the prudence of official forecasts has improved recently. As regards the track-record of national macroeconomic forecasts in the last two decades, Jankovics and Sherwood (2017) use information from the SCPs (as a proxy for national fiscal plans) for a subset of Member States and provide some illustrative calculations through the aggregation of the sign of the forecast bias for real GDP (as measured by the mean forecast error) before and after the Great Recession (and consequently the recent wave of European economic governance reform). A small optimistic bias was found in the first period (2000-2007) under review, which turned into

³⁴ At the same time, it obliges euro-area Member States (only) to specify whether the budgetary forecasts have been produced or endorsed by an independent institution.

a slightly conservative stance in the second period (2014-2016).³⁵ As regards national budgetary forecasts, based on a very similar methodology, European Commission (2014) reported an optimistic bias for the headline balance projections, to the tune of 0.4 pp of GDP on average. Turning to more recent years, overview reports by the Commission (2016a, 2017, 2018) found that EU average headline balances turned out better than forecast in the successive vintages of SCPs by 0.3-0.4 pp. of GDP over the 2015-2017 period, i.e. again, a moderate reversal of the bias.

However, a number of important caveats call for caution in interpreting those results. First, as mentioned previously, there have been other important pieces of EU legislation apart from Directive 2011/85 (most notably, the independent production or endorsement requirement set out in Article 4(4) of Regulation 473/2013). They could have had more impact on the national authorities' forecasting behaviour. Secondly, only a short period has elapsed since the entry into force of the fiscal governance reforms at both European and national level. Thirdly, policy-makers tend to be more optimistic in good economic times, while forecasting more cautiously in bad times. The slow and protracted recovery in many Member States after the depths of the crisis could therefore have played a role in the observed reversal of the sign of the forecast error.

Graph 3.2.1: **Evolution in forecast prudence compared to the pre-crisis period** (stakeholders' views)



Source: Stakeholder survey

Nonetheless, stakeholders' views corroborated the mildly positive assessment emerging from the empirical studies. A significant number of Member State experts and practitioners were of the view that forecasts had become more plausible recently, in particular if compared to the years leading up the crisis (2000-2007). As can be seen in Graph 3.2.1, 40% of the surveyed stakeholders saw such an improvement in macroeconomic forecasts, and 30% in budgetary forecasts (noteworthy, no entity assessed that the situation had deteriorated). A similar conclusion can be drawn from the

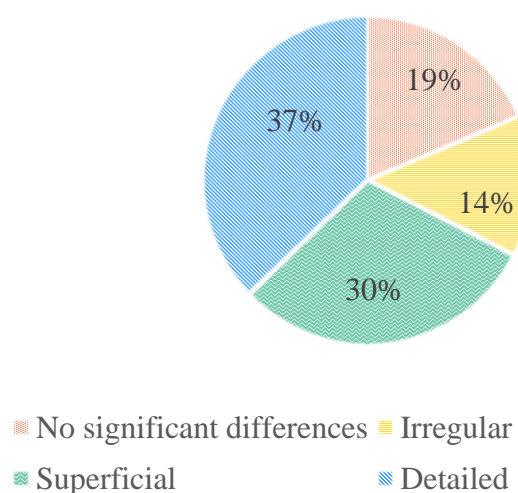
³⁵ The quoted study presents the results for two subgroups of Member States (euro-area economies with or without an independent forecaster), but it also makes possible a comparison of the accuracy projections in the two periods without the applied distinction.

Commission’s assessments of the plausibility of the macroeconomic forecasts underlying SCPs and DBPs. Slightly over three-quarters of its assessments issued between autumn 2015 and spring 2018 concluded that the macroeconomic scenarios were plausible or even conservative, while the remaining quarter assessed the scenarios as optimistic, which primarily concerned the outer years of the medium-term forecast horizons in the SCPs³⁶.

Transparency through forecast comparisons and explanations

The transparency of the national forecasts could be improved by systematic comparisons and explanations for major differences *vis-à-vis* the Commission’s forecasts. The Commission’s macroeconomic and budgetary forecasts, in particular its external assumptions and projections for foreign trade, have traditionally served as a numerical benchmark for national macro-fiscal scenarios. Directive 2011/85 sought to increase transparency by obliging the national authorities – pursuant to Article 4(1) – to present explicit comparisons of their forecasts with ‘the most updated forecasts of the Commission’ and to provide explanations of ‘significant differences’.

Graph 3.2.2: **Explanations about the differences between the Member State’s macro-fiscal scenario and the Commission’s forecast** (stakeholders’ views)



Source: Stakeholder survey

³⁶ The Commission uses essentially five categories in its assessments on the realism of the official macroeconomic scenario: i) markedly cautious; ii) cautious; iii) plausible; iv) favourable/optimistic; v) markedly favourable/optimistic. The Commission’s assessments on SCPs are available at: https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/stability-and-convergence-programmes_en and on DBPs at: https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/annual-draft-budgetary-plans-dbps-euro-area-countries_en.

While Member States have generally introduced corresponding legal provisions following the adoption of Directive 2011/85, implementation differs. Transposition was warranted also where some practice predated Directive 2011/85 without being based on legal acts, so as to anchor the comparison principle more firmly. However, practice varies among Member States. About a third have developed comprehensive and systematic coverage for such comparisons, which are currently included in all national fiscal planning documents. In a quarter of Member States comparisons to date have either been missing from a key national document (typically the annual budget documentation) or they have covered only one dimension (typically the macroeconomic projections). Finally, there are still a number of countries where relevant practice has not been established yet, for example because of the very recent introduction of transposing provisions in the domestic legal order or the lack of proper national provisions.

When comparison of national with Commission forecasts reveals significant differences, Directive 2011/85 requires that these be ‘described with reasoning’. Assessing the appropriateness of this provision as set out in Article 4(1), which is arguably rather general, would require a survey of how Member States have implemented it in practice. However, that task is objectively limited by the fact that in many cases there have been no major differences between the national and Commission projections in the recent period. Consequently, the lack of explanatory texts may simply reflect the convergence of views on the forecasts. The stakeholders share that interpretation (see Graph 3.2.2). A number of respondents from Member States with episode(s) of significant differences highlighted timing differences and sequencing as important factors. Specifically, in case of both medium-term fiscal plans and draft annual budgets, at the time of the preparation of the national baseline scenario, the available Commission’s forecasts are already four or five months old and thus based on different information. If that factor is the main reason for the differences (rather than e.g. a different appreciation of tax elasticities or impacts of new policy measures), the explanations are naturally succinct. Even so, 37% of respondents assessed the justifications available in national documents as detailed.

Specification of forecasting responsibility and methodological transparency

Article 4(5) of Directive 2011/85 requires Member States to ‘specify which institution is responsible for producing macroeconomic and budgetary forecasts’. Moreover, with a view to increasing transparency, Member States ‘shall make public the official macroeconomic and budgetary forecasts prepared for fiscal planning, including the methodologies, assumptions and relevant parameters underpinning those forecasts.’

Specifying responsibility for the provision of the official macroeconomic and budgetary forecasts was one of the least problematic elements from a transposition angle. The ease of transposition is reflected in the fact that the Directive *per se* did not trigger any change in the mandates of national forecasting institutions. It rather led to the formalisation of the existing practices in the few cases where they were not already explicitly laid down in legislation. Most notably, countries that had in the past delegated the production of the official macroeconomic forecasts to independent fiscal institutions (i.e. Austria, Belgium, Luxembourg, the Netherlands, Slovenia and the United Kingdom – in the latter case, the mandate also covers the fiscal baseline forecast) continued to rely on those arrangements.

Member States are required to make public not only the outcome of the forecast, but also their methodology so as to allow better scrutiny of quality. While some half of the Member States have transposed the related requirements into their national legal order, it is the practice, rather than legal provisions that is key to the effectiveness of that requirement. In general, explanatory documents related to the macroeconomic forecasts (including in some cases the description of the models in use) are typically far more available than information about budgetary forecasting techniques. In that domain, the independent fiscal institutions with the mandate to produce the forecasts (see above) clearly constitute one type of best practice (see in particular the ‘Briefing notes’ series by the United Kingdom’s Office for Budget Responsibility or the Luxembourgish STATEC’s series on ‘Economie et statistiques’). Another type of best practice is in place in a number of Member States where governments provide a rich set of information on both the macroeconomic and budgetary forecasts, including through self-standing technical notes; Denmark, Ireland, Slovakia, and Sweden can be singled out in that respect. In contrast, a handful of Member States have made available so far only some technical assumptions listed in an annex of a fiscal planning document.

Sensitivity analysis

A customary way to recognise and better appreciate the uncertainty inherent in the macro-fiscal forecasts underlying policy plans is to estimate their sensitivity to changes in key parameters. Doing so is a means of illustrating ways in which the economy and the budget might diverge from the baseline. Such analysis is typically carried out through altering a number of key economic parameters or assumption judgements in isolation (sensitivity analysis), but other approaches are also possible (albeit technically more challenging), such as looking at fully-fledged alternative economic scenarios or publishing the probability distribution around the central scenario in a ‘fan chart’.

Directive 2011/85 requires Member States to conduct forecast sensitivity analyses when preparing budgetary documents. Notably, Article 4(4) specifies two types of shocks to be investigated as a minimum (‘(...) shall examine paths of main fiscal variables under different assumptions as to growth and interest rates.’). It should be recalled that – with the exception of Croatia which acceded to the EU in July 2013 – all Member States had been preparing some sensitivity analyses as part of their SCPs long before Directive 2011/85 was adopted. This was part of the model structure of the SCPs, as defined in the Code of Conduct³⁷ (‘(...) in order to enable the Commission and the Council to consider the complete range of possible fiscal outcomes’), with even more specifications on the types of shocks to be covered. In particular, the Code of Conduct specifies that the underlying assumptions about how revenues and expenditures are projected to react to variations in economic variables should be shown. For non-euro area Member States, the analysis in the convergence programmes should include the impacts of different exchange-rate assumptions on the budgetary and debt position.

A third of Member States limit themselves to providing a sensitivity analysis in their SCPs rather than in domestic fiscal planning documents. In some of those cases, the

³⁷ The Code of Conduct in force is available at: <http://data.consilium.europa.eu/doc/document/ST-9344-2017-INIT/en/pdf> ; specification on sensitivity analysis can be found on p. 21.

calculations cover only various assumptions as to the GDP trajectory and provide no shock scenarios on interest rates. On the other hand, over half of the Member States do publish analysis in their national documents, in most cases with comprehensive coverage of shocks. A few Member States not only attach a sensitivity analysis to their official forecasts, but also issue separate reports on fiscal risks, the scope of which is much wider than required by Directive 2011/85, e.g. including risks stemming from contingent liabilities or from operations in the financial sector.³⁸

Regular forecast evaluations

Preparing regular evaluations on forecasting performance is important for a number of reasons. First, analysing how outturns have evolved relative to the respective forecasts allows learning lessons for future forecasts by better understanding the underlying drivers of the economy and public finances. Secondly, it represents a systematic way of measuring the performance of forecasting assumptions and models in use. Last but not least, transparently reporting on the reasons for differences between projections and outturns reinforces the accountability of the forecasting institutions.

Against that backdrop, Article 4(6) of Directive 2011/85 requires the macroeconomic and budgetary forecasts for fiscal planning to be subject to ‘regular, unbiased and comprehensive evaluation’. Such evaluations must be made public. Directive 2011/85 also establishes the obligation for a formal follow-up where a significant bias is detected for macroeconomic forecasts over a period of at least four consecutive years. The requirements related to forecast evaluation warrant important conceptual clarifications. First, dedicated, backward-looking evaluations of forecast accuracy for the purposes of Directive 2011/85 are not to be confused with and substituted by plausibility assessments of forward-looking projections prepared in ‘real-time’ by an independent fiscal institution (which is now routine in almost all Member States). Secondly, to be able to detect a possible systematic bias in forecasting, *ex post* evaluation should cover several forecasting rounds, thereby going beyond assessing the budgetary execution or forecast accuracy for a single year. Finally, it is worth noting that the initially adopted national transposing measures often missed some required design elements (e.g. coverage of both macroeconomic and budgetary track-record in the evaluation, specification of the retrospective time horizon of at least four years), which Member States had to address subsequently.

Possible misinterpretations concerning Article 4(6), at least in the first few years after the entry into force of Directive 2011/85, are likely to be one of the chief reasons why so far less than half of Member States have issued some form of relevant publication. The stakeholder survey largely confirmed that hypothesis, as many institutions (both the ministries of finance and IFIs) answered the relevant question by citing the (forward-looking) forecast plausibility assessment carried out by the respective IFIs. Concerning the remaining cases, in roughly a quarter of Member States, the domestic transposition has already taken place (albeit admittedly quite recently), but the first report is yet to appear. Further progress is needed in less than one-fourth of Member

³⁸ In the UK, this is a biannual regular publication by the independent Office for Budget Responsibility (‘Fiscal risk report’); in Cyprus (‘Report on financial risks’) and Latvia (‘Declaration on fiscal risks’) it is prepared by the Ministry of Finance as part of the annual fiscal planning documentation.

States, where the corresponding legislation is still missing or lacks some of the specifically required elements.

In spite of the admittedly slow take-up of *ex post* forecast evaluation, there are already some good practices in various administrative settings. The typical solution has been to delegate that function to an IFI. This was a natural choice in Member States where such a practice started even before adoption of the Directive. For example, in the UK, the OBR has since 2011 published the annual ‘Forecast evaluation report’ to take stock of the accuracy of its own forecasts, while since its establishment in 2007 the Swedish Fiscal Policy Council periodically (in every 3-4 years) included in its ‘Annual Report’ a dedicated section with *ex post* evaluations of the government’s forecasts. There are other Member States (Austria, Finland, Luxembourg, Portugal and Spain) where an IFI had been charged with producing this evaluation and issued a first report relatively recently. In Austria and Luxembourg, the specificity is that the national fiscal councils are tasked to evaluate the forecasting performance of the national forecasting institutions (WIFO and STATEC, respectively).

A few Member States opted to have the forecast evaluation produced by the ministry of finance, in a kind of ‘self-assessment’. This is done in practice in the Member States concerned (such as Denmark, Hungary, Lithuania and Slovakia) either as part of the legislative documentation on the final accounts for the past budgetary year or as a self-standing evaluation study. In this context, Ireland’s and Latvia’s arrangements are worth singling out, because they seem more suitable to safeguarding the impartiality of the exercise: the government outsourced that task to the private sector by commissioning a study from independent economists/consultancy firms³⁹.

The evaluation reports released so far typically cover both macroeconomic and budgetary forecasts in the same document. For stand-alone reports, the exact frequency of publication is typically not laid down in legislation and, apart from some series (see e.g. the UK and Swedish examples above), too little time has passed to be able to discern any clear pattern. The retrospective time span of at least four consecutive years is generally ensured (an interesting case is the Finnish study, which investigated the macroeconomic forecasting accuracy of the government over 40 years between 1976 and 2016⁴⁰). With the exception of the Spanish case, the reports did not find significant bias.⁴¹

³⁹ The Irish evaluation report is available at: <https://www.gov.ie/en/publication/45c92a-evaluation-of-the-department-of-finance-macroeconomic-and-fiscal-fo/>, while the Latvian one is at: https://www.fm.gov.lv/files/tausaimnieciba/Ex-post%20assessment%20of%20forecasts_Latvia.pdf

⁴⁰ Available in English at: <https://www.vtv.fi/en/publications/fiscal-policy-evaluation-on-the-reliability-of-the-ministry-of-finance-macroeconomic-forecasts-the-short-term-forecasts-of-gdp-growth-unemployment-rate-and-inflation-for-the-years-1976-2016-under-r/>

⁴¹ In its first forecast evaluation report in October 2017, the Independent Authority for Fiscal Responsibility concluded that the government’s forecasts for the real growth rate of public consumption (as contained in the official macroeconomic scenarios for 2013-2016) showed a large bias as measured by the absolute forecast error (the report is available in English at (pp. 10-12): <https://www.airef.es/wp-content/uploads/2018-11-15-Informe-Previsiones-Macro-ING-18-oct-2017.pdf>). The government responded with a public letter to that finding, which acknowledged the bias, but pointed to its decreasing profile over the period concerned (see http://serviciosede.mineco.gob.es/Indeco/historico_airef.aspx). As a corrective measure, it laid down the following commitment: if the government baseline forecast for the year-on-year growth of public

3.2.3. Conclusions

The provisions in Article 4 of Directive 2011/85 chiefly set additional requirements for the format, content and transparency of national forecasts prepared for both annual and medium-term fiscal planning. Those requirements have typically resulted in some fine-tuning of existing approaches and procedures, without, however, having necessitated a fundamental revamp of the forecasting process. Still, transposition of the Directive's provisions, where warranted, proved to be a protracted process in many Member States. It is particularly the case for *ex post* accuracy evaluations and, to a lesser extent, for forecast comparisons and sensitivity analysis. That context is the predominant reason why implementation can be considered patchy so far, with shortcomings linked in some cases to partial coverage (e.g. deliverables placed in one type of document, but not in others) and in others to elements that have yet to be implemented (e.g. evaluations on past forecasting performance).

Overall, the emerging picture of the reliability of national forecasts is mildly positive, as demonstrated by the preliminary empirical results on forecast accuracy and supported by stakeholders' views on forecast plausibility. There have also been tangible gains in terms of the transparency of the forecasting process, which facilitates a better understanding of the forecasts' underpinnings, provides comparisons against independent benchmarks and enhances the accountability of the forecasting institutions.

Against that backdrop, it must be stressed that it is challenging to disentangle the specific impact of Directive 2011/85, as those developments were also influenced by the requirements set out in Article 4(4) of Regulation 473/2013 and other relevant factors. However, the continuous implementation of the requirements of Directive 2011/85 (e.g. producing comparisons and sensitivity analyses, conducting *ex post* evaluations, publishing methodological information) has already improved transparency of national forecasting processes, and understanding of the sources of differences and errors. Greater visibility of those elements through their more systematic inclusion in the national fiscal planning documents, and in particular the rigorous *ex post* forecast performance evaluation coupled with remedy actions to address detected biases, should lead to further improvements in that regard.

Finally, it is noteworthy that practitioners' views are positive overall on the added value of the forecast-related provisions under review. A great majority of the stakeholders surveyed see it as useful to have certain EU-level standards for national forecasts. Moreover, even some of those entities that gave a relatively low assessment of the value added of the forecast provisions of Directive 2011/85 highlighted their positive role in facilitating cross-country comparisons and improving transparency.

consumption in real terms deviate from the consensus forecast by more than 25%, it will be adjusted to bring it to that 25% range.

3.3. Numerical fiscal rules

3.3.1. General considerations

Rule-based budgetary frameworks are a key tool for promoting budgetary discipline, provided they are clear, well-designed and backed by an appropriate institutional infrastructure. Fiscal rules are a permanent constraint on fiscal policy, expressed in terms of a summary indicator of fiscal performance (Kopits and Symansky 1998). Evidence shows a recent worldwide increase in their use, pointing to a growing consensus as to the advantages. Fiscal rules in budgetary frameworks serve several purposes. By constraining policy discretion, they can primarily confer credibility on macroeconomic policies, as they overtly signal the course of fiscal policy (Kopits 2001). They can limit the government deficit bias and contain public debts (Ayuso-i-Casals 2012; Debrun *et al.* 2008; Persson and Tabellini 2000). Rule-based frameworks, however, have often been criticised for being too rigid and thereby difficult to comply with (Eyraud *et al.* 2018). By constraining discretionary fiscal policies, rules can limit the margin of manoeuvre to counteract shocks and can result in pro-cyclical policies. To overcome these shortcomings, there has recently been a trend to give the rules with design features that would make them more flexible (Schaechter *et al.* 2012). As those features added complexity, rule-based budgetary frameworks are now increasingly backed by institutional infrastructure aimed at strengthening clarity and transparency, e.g. IFIs. Evidence shows that rules with these design features and operating in an environment with appropriate institutional infrastructure, they effectively promote budgetary discipline and counter-cyclical fiscal policies (European Commission, forthcoming; Badinger and Reuter 2017; Debrun *et al.* 2008).

Directive 2011/85 calls for the adoption of national fiscal rules to support the EU fiscal framework. Its Chapter IV specifically requires having in place the use of numerical fiscal rules (NFRs) in the Member States. The Directive sees strong and country-specific NFRs as a cornerstone of strengthened budgetary frameworks. As stated in recital 16, the main underlying rationale for national rules stems from the proven track-record of rule-based budgetary frameworks in promoting budgetary discipline. In the EU context, national fiscal rules are also an essential tool for ensuring national ownership of the EU fiscal framework. Another argument supporting their introduction of national fiscal rules is their role in underpinning MTBFs, as setting ceilings and targets for specific indicators contributes to medium-term policy-making.

National fiscal rules must promote compliance with EU rules, medium-term planning, fiscal discipline and countercyclical policies. Directive 2011/85 sets overarching objectives to guide the design of national NFRs and ensure consistency with the EU fiscal framework. Under Article 5, national fiscal rules must promote compliance with the EU reference values of deficit and debt set in accordance with the TFEU. As an important anchor for fiscal policy choices in the medium term, the same article states that national fiscal rules must promote multiannual planning, including adherence to the Member State's medium-term budgetary objective. Besides budgetary discipline (see above), its recital 18 recognises the role of well-specified rules in avoiding pro-cyclical fiscal policies.

The Directive requires several essential features with a view to strengthening the design and compliance of rules. Article 6 lays down a number of features to improve the design of national NFRs and make them more binding. Thus, NFRs must contain specifications as to the following elements:

- (i) a defined target, i.e. a clearly specified numerical value or ceiling for a ‘summary indicator of budgetary performance, such as the government budget deficit, borrowing, debt or a major component thereof’ (as laid down in Article 2(c));
- (ii) a defined scope, i.e. coverage (e.g. the whole of general government or a sub-sector);
- (iii) effective and timely monitoring of compliance, based on reliable and independent by independent bodies or bodies with functional autonomy *vis-à-vis* the fiscal authorities; and
- (iv) consequences in the event of non-compliance.

In addition, Article 7 provides that the rules must be reflected in the annual budget legislation, while Article 12 requires comprehensive coverage of all sub-sectors of general government. Pursuant to Article 8, the NFR requirements do not apply to the UK.

As other EU-level legislative initiatives have promoted reforms in national fiscal rules, it is not always possible to disentangle the effect of the Directive. After the adoption of the Directive, other pieces of legislation aimed to strengthen Member States’ budgetary frameworks by means of fiscal rules channel. These include, most notably, the ‘six-pack’ regulations (which introduced new EU fiscal rules that inspired the adoption of identical or similar rules at the national level, e.g. the ‘expenditure benchmark’), the Two-Pack Regulation No 473/2013⁴² (binding the euro-area Member States) and the Fiscal Compact⁴³ (binding the euro-area and – on a voluntary basis – Bulgaria, Denmark and Romania). In addition, the macroeconomic adjustment programme applying to some Member States in the wake of the crisis required a reform of fiscal rules.

3.3.2. Main developments

In recent years, both the number and the quality of national NFRs have increased significantly across the EU. By 2018, there were roughly twice as many rules in force in the EU as there were a decade earlier, and more than three times as many as when the Stability and Growth Pact (SGP) was adopted in 1997 (Graph 3.3.1). All Member States currently have one or more fiscal rules targeting the general government sector and/or the sub-national level. This is a clear improvement relative to 2011, when a few countries (i.e. Greece, Latvia and Malta) had none. In terms of quality, since 2011 Member States have endowed their rules (either new or reformed) with significantly stronger features such as a legal basis, binding targets, independent monitoring arrangements and correction mechanisms (see Graph 3.3.2).⁴⁴

The Directive played an important role in this impressive expansion of NFRs in the EU over the last decade, while not being the only factor. The stakeholder survey confirmed that it was an important driver of fiscal rules’ reform, with other legislation included in the ‘six-pack’, ‘two-pack’ and the Fiscal Compact. All three have been

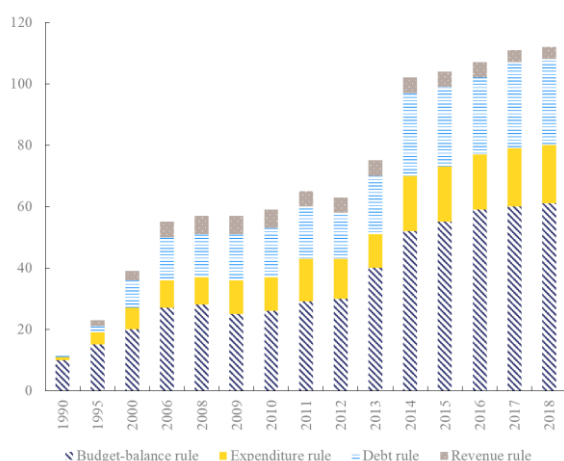
⁴² Regulation No 473/2013 provided *inter alia* that compliance with all NFRs in force in euro-area Member States has to be monitored by national IFIs.

⁴³ The Fiscal Compact set an obligation for the adhering Member States to introduce in the national legal order a structural balanced-budget rule, equipped with a correction mechanism and independent monitoring that should both respect common principles proposed by the European Commission.

⁴⁴ For more details, see Part IV of European Commission’s *Report on public finances in the EMU 2018*.

credited with an important role, but stakeholders perceive the Fiscal Compact as having been the most significant by far, as it has reportedly influenced about half of the fiscal rules reforms (see Graph 3.3.3). Therefore, disentangling the specific impact of Directive 2011/85 is admittedly quite challenging. This can be illustrated by the views of the finance ministries and IFIs in the survey. Asked to assess the impact of Directive 2011/85 on their national fiscal rules, the finance ministry and IFI from the same Member State tended to express rather different views (see Graph 3.3.4).

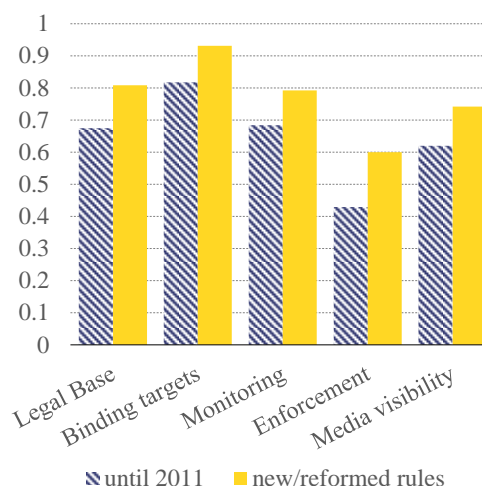
Graph 3.3.1 Number of rules in the Member States, 1990-2018



Note: the rules cover all sub-sectors of general government.

Source: European Commission's fiscal governance database.

Graph 3.3.2 Features of new and reformed rules compared to rules in force until 2011



Note: Each indicator ranges between 0 and 1 and is averaged across all rules in force.

Source: European Commission's fiscal governance database.

Since the adoption of Directive 2011/85, all Member States have implemented reforms of their NFRs, albeit on different scales. Such reforms consist of introducing new rules (in most cases), amending existing rules, or a combination of the two. The stakeholders indicated that 41% of the rules in force were newly introduced and 25% were reformed so as to include one, several or all the features required by Directive 2011/85.

The following analysis provides an overview of developments by the main NFRs provisions in Directive 2011/85. The United Kingdom is outside the analysis because the provisions on fiscal rules in Directive 2011/85 do not apply to it.

Graph 3.3.3 Drivers of fiscal rule reforms, other than the Directive (stakeholders' views)	Graph 3.3.4 Disagreement among stakeholders' as to the relative role of the Directive for NFRs
<p>A pie chart illustrating the drivers of fiscal rule reforms, excluding the Directive. The largest segment is the Fiscal Compact at 53%, followed by Two-Pack at 18%, Commitment to fiscal discipline at 14%, Six-Pack/SGP at 8%, and Macro-adjustment programme at 4%.</p>	<p>A dot plot showing the absolute value of the difference in views between IFIs and MoFs regarding the impact of the Directive on the design of national NFRs. The y-axis represents the difference score, ranging from 0 (Full Agreement) to 2 (Full Disagreement). A solid horizontal line indicates the standard deviation. The data points are scattered across the range, with a concentration between 0 and 1.</p>
<p>Source: Stakeholder survey, only MoFs.</p>	<p>Note: The graph shows the absolute value of the difference in views between IFIs and MoFs as to the impact of Directive on the design of national NFRs. The assessment on the impact of Directive was quantified with three scores: 1 – no impact; 2 – one of the factors and 3 – the decisive factor. Full agreement corresponds to no difference in the given score given, and full disagreement to a maximum difference of 2. The standard deviation is marked by the solid line. The sample comprises 21 Member States for which the responses of both the IFI and MoF were available.</p> <p>Source: Stakeholder survey.</p>

Definition of the target

National fiscal rules must be endowed with well-specified numerical targets. In the absence of a clearly defined target, monitoring and enforcement of the rules is difficult. Therefore Article 6(1)(a) of Directive 2011/85 requires that fiscal rules contain specifications regarding the target definition, which, when read with Article 2(c), has to be ‘expressed in terms of a summary indicator of budgetary performance such as the government budget deficit, debt, or a major component thereof’. In addition, Directive 2011/85 refers consistently to *numerical* fiscal rules, which implies that the target definition must include a number.

Most NFRs have a well-specified numerical target. For the vast majority of rules, the definition of the target, as set out in the relevant legislation, contains specifications of the budgetary aggregate and the numerical constraint, as required by Directive 2011/85.

- In terms of targeted budgetary aggregates, about half of the rules in force in 2018 target the budget balance, while the other half are roughly equally split between expenditure rules and debt rules. Around half of the rules of each type are rules for the general government sector (see Table 3.3.1);
- the precise formulation of the numerical constraint varies significantly depending on the budgetary aggregate and the Member State’s preferences. Still, two main groupings can be identified:

- (i) one group of rules have *explicit* numerical targets, most of which are specified in simple terms, such as 3% deficit, 60% debt, or expenditure ceilings;
- (ii) the other group clusters the rules that have *implicit* or *indirect* numerical targets. They would include rules referring to the medium-term budgetary objective (MTO) (as defined in Regulation No 1466/97), requiring a balanced budget (understood as equivalent to zero deficit), or cumulating numerical conditions, most often encountered in the case of structural balanced-budget rules (e.g. in Lithuania and Romania).

Table 3.3.1. Numerical fiscal rules in Member States by type and sector coverage (2018)

	General Government	Central government	Social security	Regional government	Local government	Sub-total
Budget balance rule	32	3	6	5	18	64
<i>of which in structural terms</i>	25					
Expenditure rule	11	5	4	2	2	24
Debt rule	19	1	0	1	7	28
<i>Sub-total</i>	62	9	10	8	27	116

Note: The strongest shade of green (red) marks the biggest (smallest) number. Due to their particular nature, revenue rules have been excluded from the analysis (in 2018 there were only three such rules in place in the EU).

Source: European Commission's fiscal governance database.

Some target definitions, while precisely specified, can be very complex. The complexity of some rules derives either from detailed target formulas involving a multitude of indicators and time periods or from the desire to define a target that would cater for many different contingencies.

Scope of the rules

The scope of national fiscal rules should be defined scope in terms of sector coverage. If rules fail to cover a significant part of the general government sector, it could weaken the effectiveness of the entire fiscal framework by providing opportunities for budgetary overruns. Accordingly, Article 6(1)(a) requires fiscal rules to contain specifications as to their scope, i.e. the sub-sectors of the general government or components thereof. At the same time, Article 12 requires that fiscal rules consistently and comprehensively cover all sub-sectors of the general government.

All NFRs in force in the Member States specify the sub-sector(s) of general government to which they apply. The vast majority of rules target either the general government as a whole (about half of the rules) or the local/regional government sub-sectors (a third). The remainder (around 15 %) cover the central or social security sub-sectors (see Table 3.3.1). Compared to 2011, rules targeting the general level of government have become more prevalent than those targeting any other level (see also section 3.5).

All Member States have fiscal rules that consistently and comprehensively cover all the sub-sectors of the general government. All Member States have at least one fiscal rule at the general government level (Bulgaria, Austria, Hungary and Latvia have three or more); in about one-third, these are the only rules, as there are none at sub-national level.

For rules to have an impact and ensure fiscal discipline, compliance needs to be assessed in a timely manner on the basis of analysis by independent bodies. Effective and timely monitoring is especially warranted where the rules are complex and numerous (as is now the case in several Member States), so their interplay might be harder to interpret. Moreover, the monitoring bodies have to be able to function independently of the fiscal authorities, in order to ensure effective and timely monitoring. With this in mind, Article 6(1)(b) requires the rules to contain specifications regarding the effective and timely monitoring of compliance, based on independent analysis by independent bodies or bodies endowed with functional autonomy *vis-à-vis* the fiscal authorities.

NFRs are generally monitored by independent bodies. With the backing of national legal provisions, the monitoring is conducted by independent bodies or bodies endowed with functional autonomy *vis-à-vis* the budgetary authorities, such as fiscal-council type of IFIs (for over two thirds of the rules) or court of auditors with an IFI-like rule-monitoring mandate. Usually, such bodies have a legal mandate to monitor all rules at the general government level, but in a few cases it extends to some or all of the rules at sub-national level (e.g. Italy, Spain).

In practice, most IFIs produce detailed and comprehensive ex-post assessment of compliance. The vast majority of IFIs or court of auditors endowed with an IFI-like mandate tend to deliver their ex-post analysis of compliance in a report published usually in a timely manner before the preparation of the draft budget for the following year. Once an IFI is charged with the task of monitoring fiscal rules, such reports generally become a systematic practice. They are published before mid-year – usually in the spring – in all Member States except for Bulgaria and Lithuania (autumn). The analysis in them tends to be detailed and generally comprehensive in covering all fiscal rules within the mandate of the body in question. Nevertheless, in a few instances (e.g. Estonia, Lithuania, Romania, Slovakia, Ireland and Italy), an ex-post analysis of compliance with certain rules (typically other than the structural balanced-budget rule) could not always be identified in the IFI reports. In Poland, the ex-post monitoring report of the National Audit Office, while very detailed, focuses on accounting and financial accuracy and lacks a proper assessment of compliance with the rules.

Independent monitoring of compliance appears to be weaker at the sub-national level. A diverse set of monitoring arrangements can be observed across the Member States for sub-national rules. Apart from cases where IFIs or court of auditors with an IFI-like mandate are involved, other monitoring arrangements (which concern a fifth of the sub-national rules) rely on bodies such as regional audit chambers, regional government entities or local finance committees, the finance ministry or some other central government body. While some of those arrangements involve a strong and independent monitoring role (e.g. the regional audit chambers in Poland), others (in particular, where the finance ministry or other central government body is the only monitoring institution) do not always fulfil the conditions for independent analysis. Such rules would benefit from the analysis by established independent institutions with experience in monitoring of fiscal rules.

While mandating the need to specify consequences in the event of non-compliance, Directive 2011/85 leaves to the Member States the decision on the type of consequences. The requirement in Article 6(1) regarding that feature of the NFRs is general and merely sets an obligation to specify in the statutory base of the rule the consequences in the event of non-compliance, thereby leaving to the Member States the choice of concrete consequence(s) for non-compliance in each case. This contrasts, for example, with the detailed requirements for the correction mechanism of the structural balanced-budget rule enshrined in the Fiscal Compact.⁴⁵

Most Member States have specified the consequences of non-compliance in the form of corrective measures. For the vast majority of the rules, national legislation specifies the consequences of non-compliance and most often take the form of corrective measures that vary in the level of detail regarding triggering and nature, size and timeline of the correction. Interestingly, the degree of specification regarding the corrective measures does not appear to vary so much in relation to the level of government they apply to, as rules targeting general government and the local level can have equally precise and detailed corrective measures. National preferences seem to be a more important determinant in that respect.

Fiscal rules targeting general government, and even some rules at sub-national level, tend to have well-defined correction mechanisms to deal with situations of non-compliance. This is most often the case with structural budget balance rules, but also some debt rules or expenditure rules at general government level grounded in the same legal base as the structural budget balance rule. The correction mechanisms, particularly for the structural balance rules (which is first and foremost a consequence of the Fiscal Compact), are characterised by:

- (i) an automatic trigger in the event of a deviation observed by an IFI or a decision by an EU institution; and
- (ii) measures to correct it within a certain timeline that must be announced/taken within a pre-defined time after observance of the deviation.

In several cases, the rule specifies that the size of the correction should be proportionate to the size of the deviation or, more strongly, that each budget must be adopted in compliance with the rule. In Austria, Germany and Latvia, the correction mechanism for the structural budget balance rule includes a system of control accounts recording cumulated past deviations. At the same time, some Member States, rather than specifying the full details of their correction mechanisms, resorted to introducing in the national legislation direct references to the SGP or the Fiscal Compact. In some Member States (e.g. in Estonia, Germany, Poland, Lithuania), the rules at sub-national level may also have detailed and well-specified corrective action (often allowing the possibility by central authorities to override non-compliant budgets), the activation of which is determined by high-frequency monitoring at quarterly or greater frequency.

⁴⁵ See Commission Communication on *Common principles on national fiscal correction mechanisms* – (COM(2012) 342), according to which key features of a well-defined correction mechanism include the automaticity of its triggering in the event of deviation and the pre-determined size and timeline of the corrective measures.

For a minority of rules, the consequences of non-compliance other than corrective measures are listed in their statutory base. For example, some of those consequences may involve certain financial restrictions (e.g. prohibition to issue guarantees, as is the case for a local government rule in Romania), political or criminal responsibility (expenditure and debt rules in Poland) or merely reputational costs (two of the general government rules in Hungary and in Lithuania). ‘Reputational costs’ are arguably the weakest type of consequences of non-compliance and more tangible consequences could increase the effectiveness of the rules in question.

Escape clauses

The Directive accepts some flexibility around the rule in the form of escape clauses, provided they are limited in number and well-defined. The academic literature has long argued that there should be some flexibility to shocks and events outside the control of the government for rules to be credible, viable, workable and long-lasting. At the same time, safeguards should be in place to limit the possibility of an abuse. As a result, Directive 2011/85 allows for NFRs to be given a degree of flexibility in the form of escape clauses, while not requiring them to be present. However, it does set some requirements as to the specification of any escape clauses that do exist. Specifically, Article 6(2) provides that ‘If numerical fiscal rules contain escape clauses, such clauses shall set out a limited number of specific circumstances consistent with the Member States’ obligations deriving from the TFEU in the area of budgetary policy, and stringent procedures in which temporary non-compliance with the rule is permitted.’

Most escape clauses consider the exceptional circumstances included in the EU fiscal framework. About half of the NFRs in the Member States have escape clauses, most of which are newly introduced rules at the level of general government. With the exception of Sweden, all Member States have at least one rule at the general government level (and in many cases all rules targeting that level) that has an escape clause. By and large, such clauses are limited in number and are formulated in terms of exceptional situations such as severe economic downturn (occasionally explicitly referring to the euro area or the EU) or catastrophic events (including threats to national security) with significant financial impact. The overwhelming majority of escape clauses for the general government rules include a direct reference to the ‘exceptional circumstances’ as defined in the SGP or the Fiscal Compact or refer to a decision by the Council. Other than exceptional events, circumstances for temporary non-compliance with the rule related to structural reforms having a significantly positive impact on the sustainability of public finances are sometimes specified in the legal basis (e.g. the structural balanced-budget rule in Italy).

In practice, the use of escape clauses has been frequent and in accordance with the legal basis, although it has significantly decreased over time. The information reported by the Member States in the Commission’s fiscal governance database suggests that, on average, escape clauses were triggered for roughly 25% of the rules in 2015 and 2016, but for only one rule in 2017 and 2018. The experts surveyed tend to agree on the appropriateness of the triggering of escape clauses.

In almost all Member States, the budget must be drafted in compliance with the fiscal rules in force, although at times the duty to do so is not explicitly specified. To reinforce the constraining character of fiscal rules, Directive 2011/85 requires that the annual budget legislation must reflect the fiscal rules in force (Article 10). In three-quarters of the Member States, there is either an explicit legal provision stating that the annual budget legislation must be drafted in line with all fiscal rules in force or a general legal provision that the annual budget is to be based on all laws in force, which implicitly includes the legal basis of the fiscal rules. In Croatia, the Netherlands and Slovakia there is no legal requirement in that regard; however, the annual budget documentation discusses compliance with the NFRs, either in a general way or through an explicit statement confirming compliance of the budget with the fiscal rules.

Overall, Member States' practitioners found the transposition and implementation of Directive 2011/85 to be quite challenging and entailing many changes. The stakeholder consultation reveals that the Directive's provisions on fiscal rules have required significant changes (in terms of national legislation, procedures, practices, documents, etc.) (see Graphs A4 and A6 in the Annex). Moreover, they report that implementing those changes to be rather difficult, even if a little less so in relation to implementation than transposition (see Graphs A5 and A7 in the Annex). While the stakeholders mentioned a variety of idiosyncratic challenges to implementation, some of the more recurring ones refer e.g. to difficulties in calculating the output gap in small open economies, for examples, or in the distribution of targets between general government sub-sectors or entities, sometimes due to different accounting standards but also to the institutional architecture of the State.

3.3.3. Effectiveness of NFRs in meeting the objectives of Directive 2011/85

According to Directive 2011/85, national NFRs must primarily promote compliance with the EU rules and the adoption of medium-term planning. To gauge the effectiveness of those provisions on national fiscal rules, this part examines the extent to which they rules have contributed so far to attaining the key objectives specified in Directive 2011/85. This is in response to the requirement contained in Article 16(2)(b) to assess the effectiveness of numerical fiscal rules in the Member States. Alongside the goal of budgetary discipline (recital 16), national fiscal rules should enhance compliance with the Treaty reference values on deficit and debt and should promote the adoption of a multiannual fiscal planning horizon (Article 5). In addition, well-specified NFRs should contribute to reducing the pro-cyclical bias of fiscal policy (recital 18). Admittedly, the role of Directive 2011/85 in achieving those objectives cannot be easily disentangled from the one of concurrent reforms that also had a significant influence on the development of national rules in the EU. Accordingly, the evidence reported in this part of the analysis seeks to illustrate the effectiveness of national fiscal rules in general.

Design of and compliance with national fiscal rules

Specific design features have been found by the literature to enhance the effectiveness of fiscal rules. Among them are features that help guide fiscal policy to its

envisaged objectives. While those features are difficult to pinpoint, as they are ultimately country- and context-specific, the literature (Kopits and Symansky 1998) suggests that they should encompass:

- simplicity and transparency;
- a target that is clearly specified and directly linked to the main objective;
- an independent monitoring body; and
- some flexibility to allow policy-makers to face shocks.

Rules with strong design features of this kind just described have been found to have a positive impact on fiscal performance (Caselli *et al.* 2018; Debrun *et al.* 2008).

Through Directive 2011/85, Member States have introduced new design features aimed at strengthening national fiscal rules. Article 6 provides some general guidelines on how to strengthen rule design by specifying the (numerical) target and the scope of the rule, introducing monitoring of compliance based on independent analysis, and specifying the consequences in case of non-compliance. If escape clauses are in place, Directive 2011/85 calls for some specific features to clarify when and how they may be used. Overall, an overwhelming majority of Member States have successfully included those features in their frameworks of NFRs. According to stakeholders, those features have helped to improve the effectiveness of domestic fiscal rules. About 80% assessed the provisions on the design of NFRs as broadly relevant and sufficient (Graph 3.3.5). Finance ministries and IFIs display a strong consensus in most cases, with some divergence regarding the relevance of the target and sufficiency of the provisions, where the IFIs are slightly less positive.

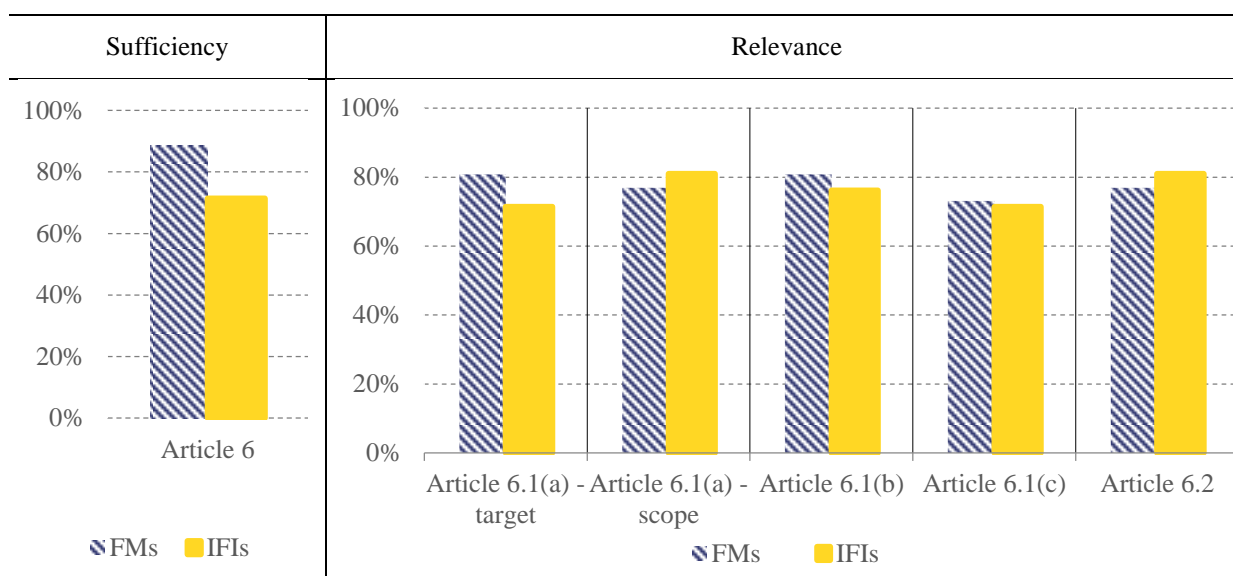
Nonetheless, according to the Member States' practitioners, some provisions of Directive 2011/85 could be made more binding. Some stakeholders indicate that the NFR-related provisions in the Fiscal Compact were more effective and more binding. For example, the precise target definition in the Fiscal Compact is deemed more relevant, while the corresponding consequences in the event of non-compliance are perceived to be more binding, as they envisage a stricter correction. To further improve the design of rules, stakeholders suggested *inter alia*:

- (i) improvements in the escape clause definition, including a more narrow definition with an exhaustive list of events in order to avoid misuses;
- (ii) stricter corrections in the event of non-compliance, including administrative fines; and
- (iii) more details on the IFIs' role regarding the assessment of fiscal rules, in particular for a comprehensive ex-ante assessment.

The widespread use of 'new generation' NFRs in the EU, to which Directive 2011/85 contributed, has increased the need for consistency among rules while creating complexity in their use. The rise in the number of rules and the addition of new design features have significantly increased the complexity of the fiscal rule framework in the EU (Deroose *et al.* 2018). Such complexity poses its own challenges. First, the number of NFRs surged in recent years (in 2018 there were nearly four rules per Member State, on average, compared to just two in 2010), implying that often now there are multiple rules constraining several budgetary aggregates of the same government level. This increase in the number of rules requires a high degree of consistency and coordination among fiscal rules, within and across sub-sectors of general government, to avoid instances of conflicting signals/constraints. Secondly, in many instances, the formulation of the target in structural terms, while adding value by increasing the rule's adaptability to economic

conditions, increases complexity from an operational point of view, in terms of translating it into concrete budgetary targets.

Graph 3.3.5: **Sufficiency and relevance of NFR provisions** (stakeholders' views)



Note: the figure shows how many responded gave a rating of 4 or 5 to the issues above (4-5 meaning highly relevant/relevant, or highly sufficiency/ sufficient). NB: that 6(1)(b) and 6(1)(c) refer, respectively, to the monitoring of compliance and consequences in event of non-compliance, 6(2) refers to the specification of escape clauses.

Source: Stakeholders survey, answers from MoFs and IFIs.

Design improvements are necessary for the effectiveness of rules, but not sufficient.

A fiscal rule endowed with the design features mentioned above is not effective if not respected. On compliance, it is reported that more than 80% of the rules for which that information was reported were complied with in 2017 and 2018, and about 70% of rules were complied with both ex-ante and ex-post.⁴⁶ This information is consistent with the findings of the literature (Reuter 2015) and the stakeholders' views. More specifically, stakeholders report high ex ante and ex post compliance in most cases, with ex-ante compliance being somewhat stronger than the ex-post compliance. Compliance seems to be more difficult with structural balance rules, in part due to difficulties with calculating the output gap, but also with expenditure rules. In most cases, stakeholders see non-compliance as the outcome of low political commitment and in fewer cases as the outcome of difficult economic times not covered by escape clause provisions. In a few instances, compliance with the rules was reported as not monitored in a timely manner, which prevented early detection and possible correction of the deviation from target.

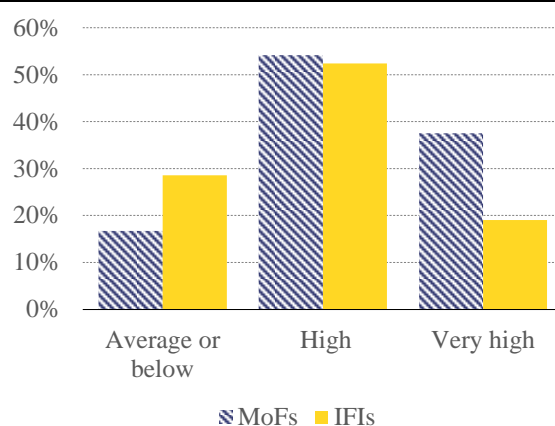
Effectiveness in promoting budgetary discipline

In line with the literature, Commission analyses and the views of Member States' practitioners concur on the NFRs' effectiveness in improving budgetary discipline. Recital 16 to Directive 2011/85 explains that NFRs should enhance domestic ownership of those EU rules promoting budgetary discipline. Given evident challenges in detecting

⁴⁶ According to information collected by the Commission (based on Member States' self-reporting) in connection with the fiscal governance database.

the degree of domestic ownership, this discussion hinges on the extent to which national fiscal rules have improved budgetary discipline more generally. The effectiveness of fiscal rules on budgetary outcomes has been widely examined in the literature (Heinemann *et al.* 2018; IMF 2009). Overall, studies find that well-designed rules improve fiscal performance (Badinger and Reuter 2017; Debrun *et al.* 2008) and might also reduce risk premia (Iara and Wolff, 2014). Regarding specifically NFRs in the EU in particular, a Commission analysis finds that budgetary discipline, expressed in relation to the cyclically-adjusted primary balance, improves with stronger and better-designed fiscal rules (European Commission 2018). Looking at the entire population of NFRs in the EU for the period 1990-2016 and relying on an estimation technique consistent with the relevant literature (Debrun *et al.* 2008), that study shows that NFRs have a positive and statistically significant impact on cyclically adjusted budget balances. Interestingly, the study also points to some preliminary evidence that as the number of rules per country increases, the marginal effect on fiscal balances diminishes. The stakeholders overwhelmingly agree that NFRs have an impact on budgetary outcomes (see Graph 3.3.6). About 80% of the stakeholders (predominantly from the ministries of finance) agree that NFRs have enhanced budget discipline. Stakeholders ascribe weak effectiveness in terms of budgetary discipline to the design of rules, and only to a much lesser extent to lack of compliance and weak enforcement procedures.

Graph 3.3.5 **Promotion of budgetary discipline**
(stakeholders' views)



Source: Stakeholders survey

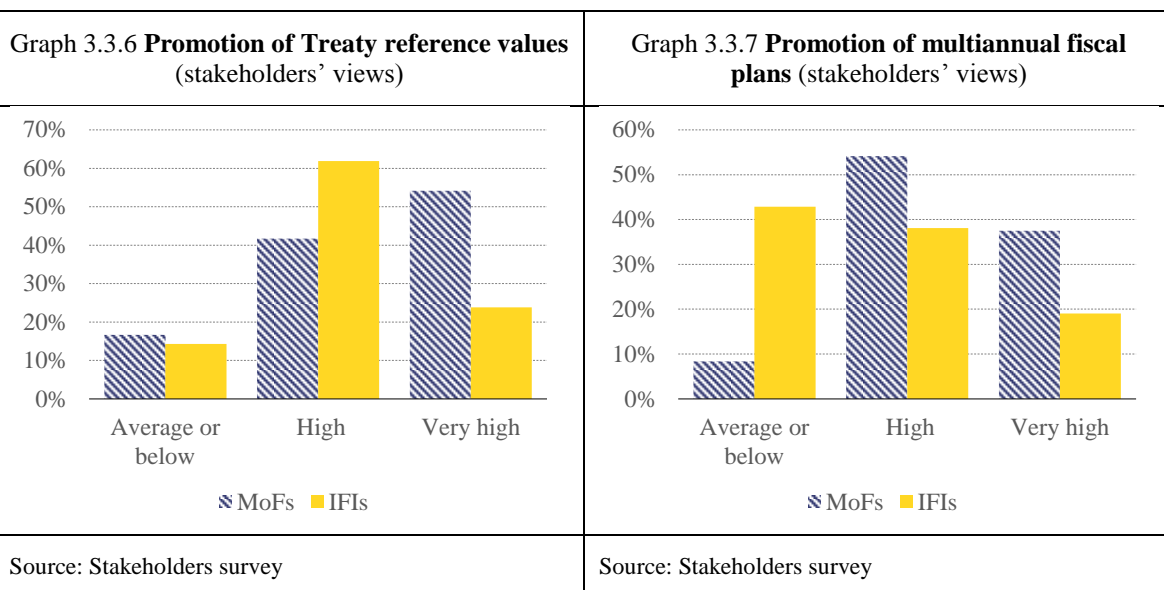
Effectiveness in promoting compliance with Treaty reference values

NFRs are perceived by stakeholders as promoting compliance with Treaty reference values. Under Article 5 of Directive 2011/85, NFRs must promote compliance with the EU reference values on deficit and debt set in accordance with the TFEU, i.e. 3% for the deficit-to-GDP ratio and 60% for the government debt-to-GDP ratio. There are significant methodological challenges in establishing whether national fiscal rules contribute to compliance with EU budgetary obligations. The evidence is quite compelling as regards the alignment of the design of national rules with the EU fiscal rules, which could be interpreted as an attempt to facilitate compliance with the latter by enshrining their features in the national legislation while strengthening the national ownership of EU rules. As previously shown, the introduction of Directive 2011/85 can indeed be associated with a surge in NFRs the design of which largely mirrors that of EU

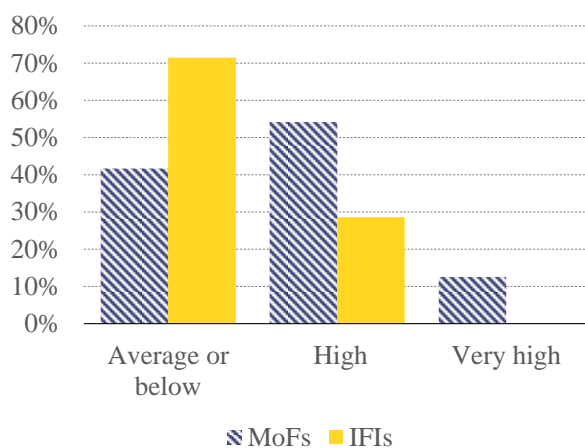
fiscal rules. Out of 62 general government rules in place in 2018, about three-quarters replicate or contain important features of the corresponding EU rules. About 51% of them are budget balance rules, 30% are debt rules and only about 18% are expenditure rules. In most cases, debt rules explicitly refer to the 60% debt reference value in the TFEU, while reference to the 3% deficit value in the TFEU is not as prevalent, with most budget balance rules targeting structural balance indicators and suggesting once more that the Fiscal Compact had a strong impact on the design of those rules. As to the extent to which NFRs effectively promote compliance with TFEU reference values on deficit and debt, only around 15% of stakeholders point to NFRs having a weak or none at all (Graph 3.3.7). However, finance ministries and IFIs differ markedly, with the former giving a more positive assessment. When promotion of the EU reference values was assessed as low, stakeholders cited issues with sub-national governments and lack of consistency across rules.

Effectiveness in promoting multiannual fiscal planning

Although most Member States’ practitioners see national fiscal rules as promoting multiannual planning, the evidence is not clear. As laid down in Article 5 of Directive 2011/85, the introduction of NFRs should promote the adoption of a multiannual fiscal planning horizon, including adherence to the Member State’s MTO. In setting targets and objectives for some specific fiscal variables, fiscal rules do serve indeed as an anchor for policymaking. Coupled with sound macroeconomic forecasts, the presence of fiscal rules should unequivocally facilitate budgetary planning in the medium term by offering a margin of manoeuvre within which policy options can be selected. Most stakeholders see NFRs as promoting multiannual fiscal planning in their Member States (Graph 3.3.8). The degree of consensus over on that issue differs between ministries of finance and IFIs, with about 90% of the former affirming a high or very high degree of promotion of multiannual fiscal plans, against only 60% of the latter. Regarding specifically the promotion of adherence to the MTO, evidence from the Commission’s fiscal governance database illustrates that most NFRs at the general government level are structural budget balance rules aiming to ensure that a Member State is at its MTO or follows an adjustment path towards it. Again, it seems likely that the design of those rules was mostly influenced by the Fiscal Compact.



Graph 3.3.8 Promotion of counter-cyclical fiscal policies (stakeholders' view)



Source: Stakeholders survey.

NFRs impact in reducing pro-cyclicality is not assessed as high by the stakeholders, at times on account of rule design. By constraining discretionary policy options, fiscal rules could limit fiscal authorities' ability to react to business cycle fluctuations. Consequently, fiscal rules have been found to be associated with a pro-cyclical fiscal stance (Manasse 2005, Fatàs and Mihov 2006). To limit the procyclical bias, novel features have been added to the design of more recent rules (also known as 'second generation fiscal rules'), to make rules better equipped to face shocks and volatility (Schaechter *et al.* 2012). Among those features are balances expressed

in structural terms or adjusted by the cycle, the introduction of escape clauses and some event-specific flexibility clauses. The introduction of these features has proven to enhance the countercyclical properties of fiscal rules (see Ayuso-i-Casals *et al.* 2007, Bova *et al.* 2014, and Cordes *et al.* 2015). To allow for more flexibility, many new or reformed national NFRs encapsulate flexible design features. Out of 104 NFRs included in the Commission's fiscal governance database in 2018, 25 target the structural balance (as opposed to the headline balance which is unrelated to the cycle); 41 have escape clauses; 13 include some budgetary safety margins; and 24 exclude some specific items from the targeted indicator.⁴⁷ Only 42 NFRs have/do none of the above. Despite the introduction of such design features (escape clauses, cyclically-adjusted targets) in many NFRs, less than half of the stakeholders see rules as effective in promoting counter-cyclicality (Graph 3.3.9). In particular, IFIs consider the impact to be rather low. In most cases, they consider it a result of rule design and, to a lesser extent, of the lack of compliance. As regards rule design, the stakeholders' positive assessment of the relevance of the design features introduced by Directive 2011/85 may point to the perception that, while those features helped to strengthen fiscal rules for budgetary discipline, they could indeed be improved to allow for more counter-cyclicality. Other reported reasons for the ineffectiveness of fiscal rules in promoting counter-cyclicality are linked to insufficient political ownership and legal enforcement, challenges in accurately identifying the current position in the economic cycle, poor estimates of potential output and a wide use of escape clauses and one-off measures.

⁴⁷ In the Fiscal Governance Database, the variable for flexibility included in the Fiscal Rule Strength Index compounds the following four dimensions: balance expressed in structural terms, escape clauses, budget safety margins and exclusions of some specific items from the target.

3.3.4. Conclusions

Directive 2011/85 was aimed at promoting the adoption or upgrading of NFRs to help to strengthen Member States' fiscal frameworks as a way of promoting compliance with the EU fiscal rules. To support that overarching objective, its provisions essentially called for NFRs to have certain features, so as to improve their design and effectiveness of those rules. Its adoption was followed by a surge in national NFRs across the EU. This cannot be attributed exclusively to Directive 2011/85, as other factors influenced the national fiscal governance landscape at almost the same time, such as other relevant pieces of EU/intergovernmental legislation or, where applicable, the macroeconomic adjustments programmes.

While Directive 2011/85 has not, and could not have, been the single most decisive factor for national NFRs, it has wielded considerable influence on their design and effectiveness. Overall, the Member States now have sets of fiscal rules that are better defined in terms of target and scope, that generally have some consequences for non-compliance attached to them, and which are usually monitored on the basis of independent analysis. Where they include escape clauses, these are limited in number and generally well-defined.

While the overall quality of the rules has improved, the complexity of the framework of fiscal rules has also increased. The design of the NFRs is strongly consistent with the EU rules and conducive to budgetary discipline. Nevertheless, there is room for further improvement, as not all required features are present in all the Member State's NFRs. Particular attention should be given to:

- laying down clear and effective consequences in the event of non-compliance (ideally in the form of a correction mechanism);
- having only limited and clearly defined escape clauses (where such clauses are warranted); and
- ensuring that rule monitoring is based on analysis provided by independent bodies.

The increase in the number of rules and refinements in their design call for a high degree of consistency and coordination among the now numerous fiscal rules, both within and across sub-sectors of the general government, in order to avoid conflicting messages. In addition, targets formulated in structural terms require a good degree of operationalisation in terms of concrete budgetary objectives. Those views have been generally echoed by the stakeholders.

As an impressive number of NFRs have been adopted or reformed relatively recently, it would be too soon to judge their effectiveness definitively. Nevertheless, preliminary evidence indicates that those design improvements have had positive effects. The consensus in the literature, that fiscal rules enhance budgetary discipline, is not only widely confirmed by the stakeholders' views on their domestic NFRs, but also by analytical work by the Commission that finds a positive and significant impact of NFRs on budget balances. In addition, stakeholders perceive NFRs as playing an important role in promoting compliance with the EU budgetary obligations in the form of the TFEU reference values on deficit and debt and, to a lesser extent, the adoption of a multiannual planning horizon. Furthermore, the large number of recently introduced NFRs introduced recently to constrain the budget balance in structural terms (primarily as a consequence of the relevant Member States' Fiscal Compact obligations) are geared

towards adherence to the Member States' MTOs. Evidence on reducing or avoiding pro-cyclical fiscal policies is rather mixed; while the rules by and large incorporate elements that should enhance counter-cyclicality (e.g. escape clauses, structural or cyclically-adjusted targets), stakeholders see room for improvement in the design of rules to provide for more effective counter-cyclical action.

The Directive 2011/85 has undeniably played an important part in the recent development of NFRs across the EU, which in turn is seen to promote compliance with the EU fiscal framework. The design features laid down in Directive 2011/85 are also considered highly relevant by stakeholders, while some of them call for stricter provisions that could make the rules more binding and ultimately improve compliance. Further reflection on how to improve the effectiveness of NFRs may be warranted, with due consideration to inter-linkages with the EU fiscal rules.

3.4. Medium-term budgetary frameworks

3.4.1. General considerations

The benefits of robust medium-term fiscal planning are widely acknowledged in the economic literature. Basing budget planning on a multiannual perspective enables the authorities to:

- assess and present the impact of their proposed policies over several years;
- signal what policy areas they are prioritising; and
- ultimately enhance budgetary discipline through better expenditure control (IMF, 2013).

Well-designed MTBFs increase transparency and provide more visibility on the trajectory of public finances for economic agents, as the medium-term orientation of fiscal policy leads to clearer and more predictable fiscal outcomes (European Commission, 2007).⁴⁸ Moreover, recent empirical analysis has found that MTBFs have a large and positive impact on fiscal outcomes, thus strengthening fiscal discipline (European Commission, 2019a).

The need to increase national ownership of the EU fiscal framework and effectively promote compliance with the Member States' obligations deriving from the EU legislation was a key argument in favour of a stronger medium-term orientation of national fiscal frameworks, which materialised in the introduction of the concept of MTBF in Directive 2011/85. Article 2 defines MTBFs as a 'specific set of national budgetary procedures that extend the horizon for fiscal policy-making beyond the annual budgetary calendar, including the setting of policy priorities and of medium-term budgetary objectives'. As set out in recital 19, MTBFs are strictly instrumental in ensuring that the Member States' budgetary frameworks are consistent with EU law. In

⁴⁸ International financial institutions and the literature use various terms to refer to the instruments of multiannual fiscal planning. For example, the World Bank uses the notion of 'medium-term expenditure frameworks', while the network of EU IFIs and the IMF use the term 'medium-term fiscal frameworks' to refer to multi-year macro-fiscal objectives and targets.

particular, if national fiscal planning is consistent with the preventive and corrective arms of the SGP, it indicates that the national budgetary framework is geared to achieving, in particular, the Member State's MTO. MTBFs can incorporate the multiannual budgetary perspective of the EU budgetary surveillance framework in the national budgetary process, with annual budget legislation being prepared on the basis of multiannual fiscal planning stemming from the MTBF (recital 20).

Directive 2011/85 required Member States to establish credible and effective national MTBFs, which should include a number of basic features. The objective of having MTBFs was to expand fiscal planning beyond the annual budget process along a horizon of at least three years and consequently foster more effective and realistic fiscal policy-making over the medium term. At the same time, for the MTBF to be effective in promoting the budgetary discipline and sustainability of public finances, it should have a comprehensive coverage of general government finances. Article 9(2) lists the elements that it should include, namely:

- (i) comprehensive and transparent multiannual budgetary objectives consistent with the NFRs (Article 9(2)(a) and recital 17);
- (ii) projections of key fiscal aggregates for the budget year and beyond, assuming no policy changes (Article 9(2)(b) and recital 21);
- (iii) a description of medium-term policies decided in the annual budgetary process and of the budgetary implications beyond the year of their adoption (Article 9(2c) and recital 20);
- (iv) an assessment of the direct impact of the envisaged policies on the long-term sustainability of public finances (Article 9(2)(d)).

Directive 2011/85 sought to establish a direct link between the annual budget and the multiannual budgetary plans. Article 10 anchors the production of the annual budgets in a medium-term perspective by requiring that the revenue and expenditure projections derived from the MTBF are used as the starting point in the preparation of the annual budget. It also provides that there should be an explanation for departures of the annual budget from the provisions of the MTBF.

Under its Article 11, Directive 2011/85 should not prevent a new government from updating its MTBF to reflect its new policy priorities. However, that government is bound to indicate the differences from the previous MTBF.

The recognition given in the EU economic governance architecture to the importance of pursuing medium-term fiscal planning in the Member States neither started nor ended with Directive. The Directive was not the first EU legislation linked to Member States' multiannual fiscal planning. Regulation No 1466/97 (which established the so-called 'preventive arm' of the SGP) first introduced the concept of the country-specific MTO seeking to ensure the sustainability of public finances or rapid progress towards it. It also required Member States to submit annually to the Commission their medium-term budgetary plans, in the form of stability or convergence programmes (SCPs). The SCPs should provide information on:

- the MTO and the adjustment path towards it;
- the expected path of the general government debt ratio;

- the planned path for general government expenditure, including corresponding allocation for gross capital formation;
- the planned growth path of government revenue assuming no policy changes; and
- a quantification of the planned discretionary measures.

However, in many instances the plans presented in the SCPs were not executed as envisaged,⁴⁹ suggesting that the link between the annual budgets and the programmes was relatively weak. Arguably, the SCPs were perceived domestically more as an EU-imposed instrument for budgetary reporting and surveillance than as a genuine tool of national fiscal policy-making. The subsequent adoption of Directive 2011/85 sought to overcome this ‘ownership deficit’ by setting certain requirements for the national MTBFs.

Since the adoption of Directive 2011/85, follow-up EU and intergovernmental initiatives have sought to complement and reinforce the medium-term perspective in national budgetary planning, with a view to facilitating compliance with the EU fiscal framework. The 2012 TSCG brought about a balanced-budget rule in cyclically adjusted terms, aiming to translate a slightly stricter version of the MTO defined under the preventive arm of the SGP into the budgetary frameworks of Member States bound by the Fiscal Compact.⁵⁰ Subsequently, Regulation No 473/2013 gave further impetus to national medium-term fiscal planning by requiring euro-area Member States to publish NMTFPs at the same time as (or as part of) their stability programmes and to prepare them on the basis of independently produced or endorsed macroeconomic forecasts.

Disentangling the specific impact of Directive 2011/85 on the design and effectiveness of national MTBFs from the influence of other EU legislation or intergovernmental provisions is not straightforward given the plethora of legal requirements and planning documents. For example, Member States may use either specific national documents laying out their medium-term fiscal strategy or SCPs as medium-term fiscal plans. The content of such documents is not necessarily identical — while the Directive 2011/85 identifies certain elements that must be included in the national MTBFs, the structural components of the SCPs and the corresponding guidance are detailed in the SGP Code of Conduct.⁵¹ Therefore, heterogeneous and coexisting documents serving a similar purpose, but governed by different requirements are bound to provide similar or overlapping input to medium-term fiscal planning, possibly even at different points in time. This can raise issues of uncertainty over the medium-term fiscal

⁴⁹ European Commission (2014), ‘Planning versus implementation: why are medium-term budgetary targets not always respected?’; chapter in *Public finances in EMU*.

⁵⁰ Apart from defining setting a stricter lower limit of a structural deficit limit of 0.5% of the GDP (or 1% for countries with a debt-to-GDP ratio significantly below 60% and with low sustainability risks), the TSCG also required contracting parties to ensure rapid convergence towards their MTO along a time frame to be proposed by the Commission.

⁵¹ Specifications on SGP implementation and Guidelines on the format and content of SCPs; http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/coc/code_of_conduct_en.pdf (http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/coc/code_of_conduct_en.pdf)

plans and consistency with annual budgets, potentially requiring reconciliation steps, depending on the timing of the documents and on the underlying accounting standards.⁵²

Slight, but potentially confusing, differences in terminology emerged with the different MTBF-related requirements. The co-existence of Directive 2011/85, the six-pack regulations and the two-pack's Regulation 473/2013 entails simultaneous requirements applying to medium-term budgetary plans (in the form of SCPs, as per the SGP) and to NMTFPs (as per the Directive and Regulation 473/2013). Moreover, the meaning of MTBF lends itself to more than one interpretation in the text of Directive 2011/85. On the one hand, there is the prevailing procedural meaning established in the MTBF definition itself (Article 2(e) refers to the '(...) specific set of national budgetary procedures (...)'). On the other hand, there is also a quantitative meaning, according to which the MTBF is the set of budgetary figures forming the medium-term path.⁵³ While the various nuances of MTBF requirements may be justified individually, a certain conceptual clarification and harmonisation might be helpful in terms of more credible and effective multiannual fiscal planning.

3.4.2. Main developments

Member States' arrangements for medium-term fiscal planning have developed significantly in recent years. In some, various forms of MTBF had actually existed even well before the SGP. Thanks in particular to requirements in key EU-level legislation such as the preventive arm of the SGP (together with the related Code of Conduct) and, more recently, Directive 2011/85 and Regulation 473/2013, there has been significant progress on multiannual fiscal planning across the EU. Consequently, today all Member States have a more or less developed MTBF in place.

The expansion and improvement of MTBFs in the EU is reflected in the fiscal governance database. The related MTBF index captures the developments that led to a strengthening of Member States' MTBFs. The index is built around five dimensions:

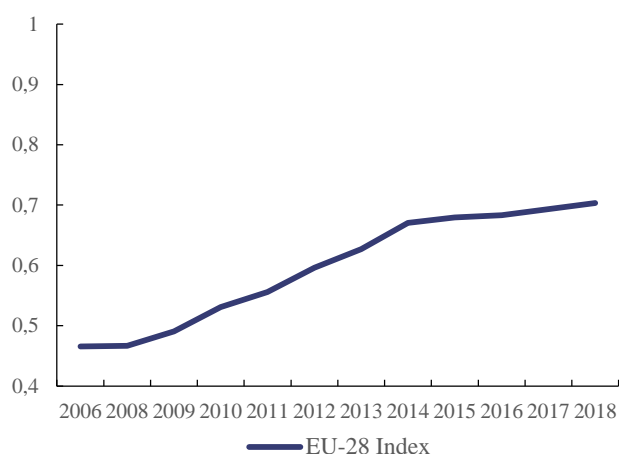
- (i) the coverage of the targets/ceilings in the NMTFPs;
- (ii) connectedness between targets/ceilings in the NMTFPs and the annual targets;
- (iii) the involvement of the national parliament or use of a coalition agreement in the preparation of the medium-term budgetary plans;
- (iv) the involvement of IFIs in the preparation of the NMTFPs; and
- (v) the level of detail in the NMTFPs.

⁵² SCPs are established in ESA2010 terms, whereas other national medium-term planning documents are typically in cash terms.

⁵³ For example, recital 20 refers to MTBFs in their procedural meaning ('planning of annual budget legislation should be based on multiannual fiscal planning stemming from the *medium-term budgetary framework*'). On the other hand, recital 21 refers to MTBFs in a quantitative sense ('That *medium-term fiscal framework* should contain, inter alia, projections of each major expenditure and revenue item for the budget year and beyond'). Finally, the set of numbers that result from the procedures of MTBFs are the *medium-term budgetary plans* or represent the *medium-term fiscal planning*, but are not the MTBF itself.

Although overall significant, progress has been uneven across specific areas of the MTBFs, suggesting there is room for improvement. Since 2006, the MTBF index has witnessed a steady upward trend, illustrating the strengthening of the medium-term planning dimension of fiscal policy. However, the latest available value of the index is still below its maximum value of 1, reflecting the fact that progress can still be made in some areas where Member States score less well. This is notably the case for the connectedness of multiannual budgetary targets with the annual budget, the involvement of IFIs in the preparation of the NMTFPs and the level of detail included in the NMTFPs.

Graph 3.4.1. Fiscal governance database' MTBF index



Source: Fiscal governance database

The documents setting out the Member States' medium-term fiscal plans are quite diverse. In half of the cases, the NMTFP is represented as a dedicated piece of legislation/coalition agreement (e.g. the Federal Budgetary Framework Law in Austria, the *Loi de programmation des finances publiques* in France, *Startnota* in the Netherlands) or a self-standing document (e.g. *Documento di economia e finanza* in Italy, fiscal and budgetary strategy in Romania). Nonetheless, the SCPs prepared for the purposes of EU budgetary surveillance can be designated as the NMTFP or be an integral part of it; this happens in two thirds of Member States, most of them from the euro area. The precise identification of the NMTFP is complicated in the majority of Member States by the fact that different documents are declared to be NMTFPs in different instances and the role of each document is not always obvious. While that diversity of fiscal planning outlets is understandable in the light of specific national budgetary procedures, using multiple documents to chart a Member State's multiannual fiscal course may produce overlaps and inconsistencies, and generate uncertainty over the 'true' medium-term path.

From the point of view of formulating budgetary targets and ensuring their stability over time, two main types of medium-term fiscal plan can be identified:

- 'fixed MTBFs' with a fixed time horizon that will not be extended on a rolling basis – this timespan usually coincides with the term of the legislature, which typically entails stronger ownership and greater willingness on the part of policy-makers to respect the fiscal plans for which they have taken political

responsibility (Sherwood, 2015). The targets can be fixed (i.e. binding for all the budget years of the framework) or revised every year under certain circumstances. Fixed MTBFs are used by very few Member States (e.g. Finland, the Netherlands, UK); and

- the vast majority of the Member States' MTBFs, which are prepared on a rolling basis, meaning that while the number of years covered remains the same, a new outer year is added every year (this is the model followed by the SCPs, for which annual updates are required by Regulation No 1466/97). On the one hand, certain annual updates of the macroeconomic projections are quite natural, so as to reflect the latest developments in the underlying variables, in particular for the outer years. On the other hand, (sizeable) updates to the budgetary projections are not conducive to a stable fiscal trajectory beyond the budgetary year if there are not strong reasons for them, e.g. they reflect the introduction of major structural reforms.

Against that general background, the analysis below provides an overview of transposition and implementation developments linked specifically to the MTBF provisions in Directive 2011/85 and identifies the main challenges faced so far.

Length of the planning horizon

Member States are currently using fiscal planning horizons of at least 3 years. Doing so corresponds to the requirement in Article 9(1) of Directive 2011/85 to establish 'a medium-term budgetary framework providing for the adoption of a fiscal planning horizon of at least 3 years'. In more than half the Member States, the minimum three-year length of the fiscal planning horizon is set in law. More than one-third operate with a four-year fiscal horizon, whereas the United Kingdom' medium-term horizon covers five budget years. The chosen length of the planning horizon is primarily influenced by country-specific administrative and budgetary considerations and therefore its appropriateness can only be judged case by case. For example, in France the multiannual programming laws should cover a minimum period of three years, while in practice that horizon is five years and corresponds to the mandate of the government. While a longer time span seems justified, for example, for MTBFs that cover the mandate of the government/legislature, there is currently no strong evidence suggesting that in general 'longer is better'. Indeed, budgetary targets set over a longer horizon can be subject to bigger revisions, as the forecasts for outer years are surrounded by more uncertainty related mainly to macroeconomic developments (in the case of nominal targets) or the unobservable nature of variables such as the output gap (for targets in structural terms). That instability could be mitigated by setting more robust budgetary targets such as real expenditure growth, for example.

Content of the MTBF

Article 9(2) of Directive 2011/85 requires that MTBFs include 'procedures' for establishing a number of items considered key for sound and detailed fiscal planning. Those items follow a logical sequence of preparing/presenting fiscal plans. Thus, Member States must set out medium-term objectives for key budgetary aggregates, indicate the starting point (i.e. baseline scenario with projections assuming no policy

changes), then lay out the medium-term policies that bridge the gap to the medium-term objectives and assess the quality of the envisaged policies considering their impact on the long-term sustainability of public finances..

Member States have endowed their MTBFs with indicators for the main budgetary aggregates. Under Article 9(2)(a), MTBFs must include ‘comprehensive and transparent multiannual budgetary objectives in terms of general government deficit, debt and any other fiscal indicator such as expenditure, ensuring that they are consistent with the numerical fiscal rules’. The transposition of Directive 2011/85 has led the majority of Member States to specify in national laws the main budgetary objectives to be included in the MTBF, using the exact wording of the Directive or something similar to define the budgetary policy indicators. In a few Member States the national legal provision is rather generic, as it does not refer specifically to public debt or the general government balance. In practice, the implementation of Article 9(2)(a) has not been problematic for most Member States, which include the required multiannual objectives in their medium-term plans. A quarter of the Member States include a structural budget balance as one of their multiannual budgetary objectives.

Most Member States provide in various degrees of detail the projections for general government expenditure and revenue assuming no policy changes. Article 9(2)(b) of Directive 2011/85 requires that MTBFs include ‘projections of each major expenditure and revenue item of the general government with more specifications on the central government and social security level, for the budget year and beyond, based on unchanged policies’. While almost all Member States have reflected this provision in their national legal order, in several cases the legal provisions make no reference to projections that are based on unchanged policies or the coverage in terms of sub-sectors is insufficient. Further progress needs to be made by the Member States with respect to presenting the relevant information fully in line with the requirements of the Directive. For example, in some Member States data are presented at the general government level only or not based on no policy changes. Recital 21 of Directive 2011/85 explains that Member States should provide the definitions and methodologies used for unchanged policies. That aspect of the Directive has received little attention, as only a minority of Member States explain the underlying methods for the unchanged policy projections, either by reference to the Commission principles (European Commission, 2016b), directly in the budgetary documents or in a self-standing document.

The description in the medium-term fiscal plans of envisaged medium-term policies and their budgetary implications by major revenue and expenditure item is often still incomplete or superficial. In order to provide an assessment of the quality of the envisaged medium-term policies, Article 9(2)(c) of Directive 2011/85 obliges Member States to provide ‘a description of medium-term policies envisaged with an impact on general government finances, broken down by major revenue and expenditure item, showing how the adjustment towards the medium-term budgetary objectives is achieved compared to projections under unchanged policies’. While almost all Member States have adopted MTBF-related legal provisions on medium-term policies that in general replicate this requirement closely, the descriptions of existing or new medium-term policies or assessments of their budgetary impact are often incomplete or non-systematic.

The requirement to assess the long-term impact of the envisaged medium-term policies has been applied in a patchy fashion. Article 9(2)(d) calls for ‘an assessment of how in light of their direct long-term impact on general government finances, the

policies envisaged are likely to affect the long-term sustainability of public finances'. Many Member States seem to have misinterpreted this provision. On the one hand, Directive 2011/85 seeks to establish the impact of the envisaged medium-term fiscal policies on the long-term sustainability of public finances. That goal implies that it is the broad set of policies presented in each medium-term fiscal plan that is concerned by this Article 9(2)(d) covers and that the provision is about their impact in the long run. On the other hand, some Member States seem to have been misled by the fact that the wording is similar (but not identical) to the seemingly narrower one in the SGP Code of Conduct in connection with the preparation of the SCPs⁵⁴ and, hence, did not adopt specific transposing provisions. In terms of implementation, in close to half of the Member States that assessment is generally available in various forms: a self-standing chapter of the SCP, in the national medium-term plan itself or in a separate document (e.g. the CPB's analysis of economic and budgetary effects of the financial appendix to the Coalition Agreement in the Netherlands). At the same time, nearly half of the Member States consider that assessment to be the debt-sustainability analysis contained in the stability programmes as mandated by the SGP (they are mostly euro-area Member States that report the stability programme as their NMTFP). Some Member States currently do not seem to present the required assessment.

Article 9(3) requires Member States to underpin the projections of the budgetary aggregates with realistic macroeconomic and budgetary forecasts. As explained in Section 3.2, there is a general trend of increasing the prudence of forecasts used by Member States in their budgetary processes.

Consistency between the MTBF and the annual budget

Annual budgets are required to be consistent, in principle, with the medium-term budgetary plans. The requirement in Article 10 of Directive 2011/85 that 'annual budget legislation shall be consistent with the provisions of the medium-term budgetary framework' has found an equivalent in the national legal order in more than three quarters of Member States. In its strictest interpretation, the link between the annual budgets and the MTBF translates into a straightforward requirement that the former must respect the limits set in the medium-term fiscal plans at any time and under any circumstances. When providing for some flexibility to be embedded in the MTBF, Member States include provisions requiring explanations in the event of annual budgets departing from the MTFPs (see below).

Nevertheless, there seems to have been a limited impact of Directive 2011/85 on the consistency of annual budgets with the medium-term budgetary plans. A vast majority of the stakeholders surveyed declare that that has remained unchanged (see Graph 3.4.2). That perception is slightly different among the finance ministries, which tend to a more positive assessment than the IFIs, which in turn are more centred on the mean (see Graph 3.4.3). For respondents who indicated an improvement in consistency, the main explanatory factors were the enhanced transparency in the MTBF, the need to

⁵⁴ '(...)the programmes should outline the countries' strategies to ensure the sustainability of public finances, especially in light of the economic and budgetary impact of ageing populations and the fiscal risks stemming from contingent liabilities'.

explain deviations of the annual budget from the multiannual budgetary plans and the introduction of clear provisions to align the annual budget with the medium-term budgetary plans. Nonetheless, where it is possible to update the multiannual budgetary plans every year, that consistency is easy to achieve, in particular when the update is made at the time of the presentation or adoption of the annual budget.

Member States must duly explain any departure of the annual budget from the revenue and expenditure projections laid down in the MTBF. A few Member States provide for strict compliance of the annual budget with the ceilings/targets in the MTBF. For more than half, the link between the annual budgets and the NMTFPs is potentially weaker. In those cases, the legal provisions require the annual budgets to ‘be compiled on the basis of’, ‘be based on’, ‘follow the objectives of’, ‘be framed by’ or ‘be consistent/coherent with’ the NMTFPs and generally require explanations in the event of departure from the plans. In Bulgaria, Latvia and Luxembourg, the MTBF and the annual budgets are prepared at the same time, therefore automatically ensuring consistency with the plans for the first year ahead. In the remaining Member States, a dedicated transposing provision is either missing or is incomplete (e.g. a requirement to report, but not to explain discrepancies).

<p>Graph 3.4.2: Consistency of annual budgets with medium-term budgetary plans (stakeholders’ views)</p>	<p>Graph 3.4.3: Degree of consistency of annual budgets with medium-term budgetary plans (stakeholders’ views)</p>																										
<table border="1"> <caption>Data for Graph 3.4.2</caption> <thead> <tr> <th>Category</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>Worsened</td> <td>~5%</td> </tr> <tr> <td>Remained the same</td> <td>~70%</td> </tr> <tr> <td>Improved</td> <td>~25%</td> </tr> </tbody> </table>	Category	Percentage	Worsened	~5%	Remained the same	~70%	Improved	~25%	<table border="1"> <caption>Data for Graph 3.4.3</caption> <thead> <tr> <th>Rating</th> <th>MoF (%)</th> <th>IFIs (%)</th> </tr> </thead> <tbody> <tr> <td>1</td> <td>0</td> <td>~5</td> </tr> <tr> <td>2</td> <td>0</td> <td>~5</td> </tr> <tr> <td>3</td> <td>~10</td> <td>~55</td> </tr> <tr> <td>4</td> <td>~45</td> <td>~20</td> </tr> <tr> <td>5</td> <td>~55</td> <td>~20</td> </tr> </tbody> </table>	Rating	MoF (%)	IFIs (%)	1	0	~5	2	0	~5	3	~10	~55	4	~45	~20	5	~55	~20
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3.4.3. Effectiveness of MTBF

Directive 2011/85 explicitly requires the Member States to establish credible and effective MTBFs (Article 9(1)). The rationale is straightforward: an effective MTBF is conducive to compliance with the Member States’ obligations under EU legislation and promotes budgetary discipline. Recent empirical evidence suggests that Member States’ MTBFs have a strong, positive and statistically significant impact on fiscal outcomes

measured by the cyclically adjusted budget balances (European Commission, 2019a).⁵⁵ However, despite the gradual improvement of the MTBFs' design, as reflected in the MTBF index computed on the basis of the fiscal governance database, several dimensions of that index still score quite low, in particular the link between annual budgets and medium-term budgetary plans, the involvement of IFIs in the preparation and the level of detail of the NMTFPs. This is likely to undermine the effectiveness of MTBFs and warrants further improvement effort.

Several factors determine the effectiveness of MTBFs. The most relevant dimension is the binding nature of the medium-term fiscal plans, as determined by the extent to which annual budgets respect the medium-term path of public finances set in the MTBF. A second dimension is the frequency and scale of the revisions of multiannual fiscal plans allowed by the MTBF. Thirdly, the extent to which explanations are provided in the event of the annual budget parameters departing from the medium-term plans is also a key factor. Finally, other elements contributing to effectiveness (both covered in the relevant sections of the review) are the MTBF's coverage of general government bodies and funds that are outside the regular budgets and the coordination arrangements between sub-sectors of general government in terms of setting and achieving budgetary objectives. Outside the scope of Directive 2011/85, political commitment plays a key part in ensuring that the MTBF effectively delivers on the overarching objectives of fiscal discipline and compliance with EU rules.

While the Directive's provisions include certain design features and define the required content of MTBFs, they can do very little to make MTBFs genuinely binding. No provision prevents Member States from updating their MTBFs yearly (or even twice a year, as is the case for Italy) in terms of multiannual objectives and the path towards them, and. Moreover, there is no obligation to explain adjustments between successive plans, except when a new government takes office (see Article 11). As a result, with the exception of a limited number of Member States with fixed or highly binding MTBFs, short-term budgeting remains a high priority, as annual budgeting plays a very prominent role in the overall budgetary process. This in turn leads to annual adaptations of the MTBF to suit the more immediate needs of annual budgeting, which is the opposite to what was envisaged in calling for Member States' annual budgets to be consistent with the MTBF.

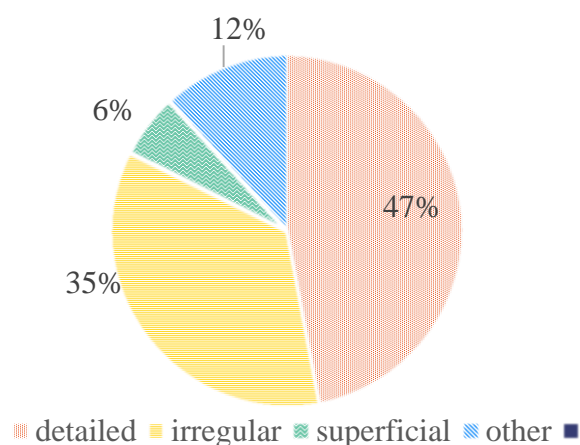
The binding nature of the MTBF in relation to the annual budgetary plan is one determinant of how conducive to fiscal discipline an MTBF is. The extent to which annual budgets pursue the fiscal trajectory laid down in the medium-term budgetary plans and the specification of circumstances allowing planned departures therefrom are key for the effectiveness of an MTBF. In this respect, Directive 2011/85 includes rather general provisions regarding the link between annual budgets and multiannual fiscal planning, in that its Article 10 requires 'consistent annual budget legislation' and states that medium-term projections 'constitute the basis for the preparation of the annual budget'.

⁵⁵ Looking at the effectiveness of the national fiscal frameworks in the Member States, the analysis finds that (for the period 2006-2015 for which data are available) MTBFs have a strong, positive and statistically significant impact on cyclically adjusted primary balances. Specifically, the impact amounted to more than 1 pp. of potential GDP for a one-unit increase in the standardised MTBF index (calculated on the basis of the fiscal governance database), an impact which is robust to several estimation techniques.

Another determinant of MTBF effectiveness relates to the frequency, timing and circumstances for introducing revisions to the NMTFPs. Directive 2011/85 does not indicate how often the MTBF and the resulting fiscal plans should be updated or revised, implicitly advocating that they should be as stable as possible and not necessarily undergo changes every year. In that respect, Directive 2011/85 differs from other provisions on medium-term planning in EU law, e.g. Regulation No 1466/97, which requires Member States to submit their SCPs to the Commission annually (in April), and Regulation No 473/2013, which requires them to publish their NMTFPs annually (also in April). In practice, two thirds of the Member States update their MTBFs annually. In a few, the MTBF can in theory be updated with every new available forecast, typically in spring and autumn. On the other hand, more stable MTBFs (in the sense of being less frequently updated in terms of budgetary objectives) exist in a few other Member States, such as France, Ireland, Lithuania and the Netherlands. As far as timing is concerned, the NMTFPs are typically updated in the spring (in connection with the requirement to send SCPs to the Commission in April), whereas some Member States do the update in the autumn. When the update coincides with the approval of the budget for the following year and thereby annual plans are inherently consistent with the MTBF, such approach tends to weaken the MTBF *vis-à-vis* the annual budget.

Except when a new government takes office, no provision of Directive 2011/85 lists circumstances that would justify an update or revision of the MTBF in force. While economic realities often lead the Member States to adjust their medium-term targets or projections, the Directive provides no elements allowing to identify the specific cases in which such revisions may be justified (e.g. unexpected economic shocks, major structural reforms). In practice, almost no Member State defines in the national legal order the circumstances allowing for a revision of the MTBF.⁵⁶

Graph 3.4.6. Assessment of explanations for departure of the annual budget from medium-term plans (stakeholders' views)



Source: Stakeholders survey

Consistency of the targets set in the annual budget with the NMTFPs implicitly calls for a process to monitor the indicators and procedures in the event of non-compliance. While national fiscal rules are accompanied by independent monitoring and consequences in the event of non-compliance (which are meant to promote compliance, including by raising the reputational cost of non-compliance), the Directive does not provide such a toolkit for MTBFs. Member States usually charge an institution with monitoring compliance with and detecting departures from the MTBF in force. Most often, the finance ministry alone is in charge

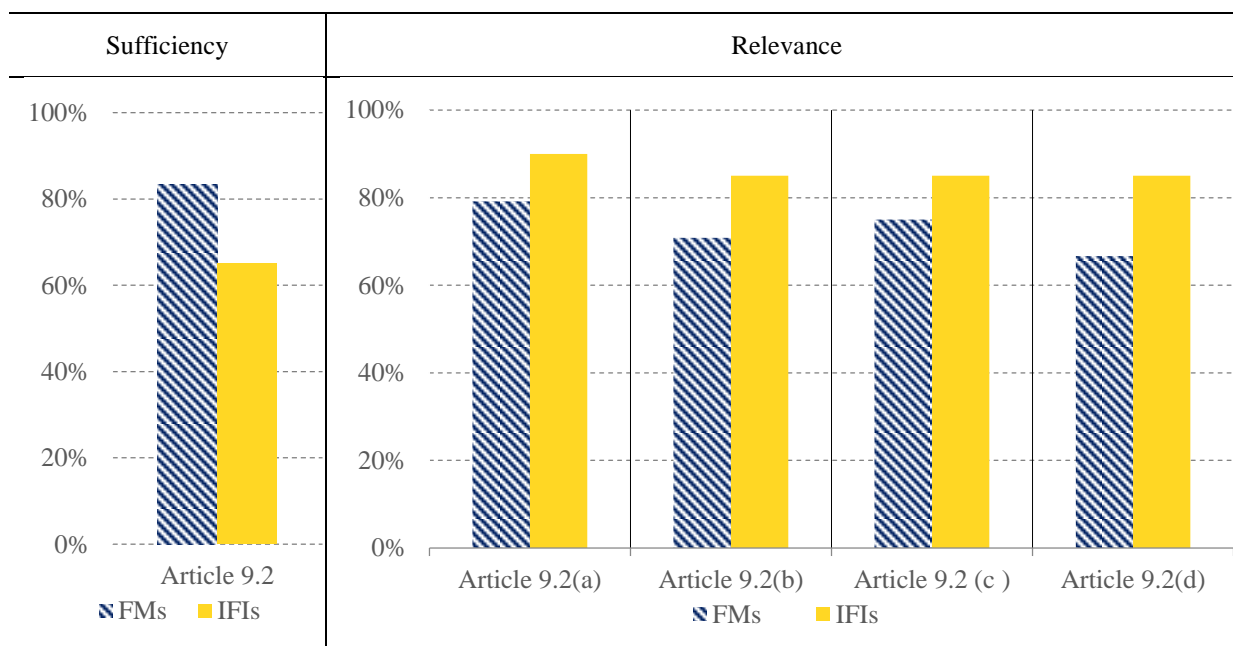
⁵⁶ Article 51.1 of the Austrian Constitution specifically lists the cases of imminent harm and those linked to the national defence that allow for a revision of the MTBF.

of monitoring *ex ante* or *ex post* the consistency of the annual budget with the medium-term objectives, without an independent institution providing a separate opinion.

According to evidence available at this stage, explanations are not systematically provided in the event of the annual budget departing from the medium-term budgetary plans. Around one-third of respondents signal such events. Explanations range from irregular to systematic and detailed (see Graph 3.4.6).

Notwithstanding those considerations on the extent to which the provisions of Directive 2011/85 support MTBF effectiveness, both finance ministries and IFIs positively assessed the relevance and sufficiency of the provisions in Article 9(2) laying down the content of national MTBFs. The IFIs attribute high relevance to all those provisions, while the finance ministries provide a more nuanced view and lower scores, in particular on the requirement to assess the long-term sustainability of public finances. By contrast, the sufficiency of Article 9(2) of Directive 2011/85 is high for the finance ministries, but receives a lower score from the IFIs, which consider that the provisions do not go far enough to ensure that the overall objectives of the Directive are achieved.

Graph 3.4.7 Sufficiency and relevance of the MTBF provisions (stakeholders' views)



Note: the figure shows in percentage points the proportions of MoFs and /or IFIs that gave a rating of 4 or 5 to the issues above (4- 5 meaning highly relevant/relevant, or highly sufficiency/ sufficient).

Source: Stakeholders survey, answers from FMs and IFIs.

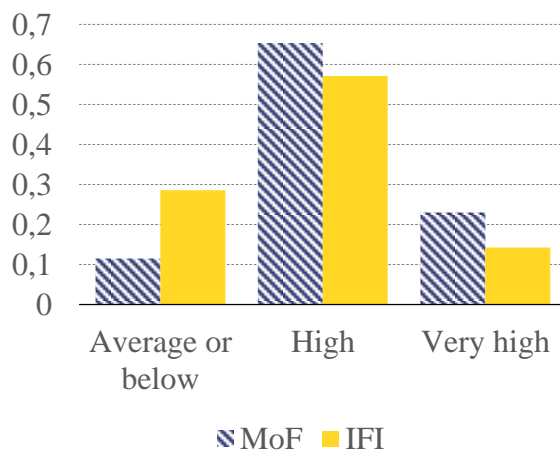
The majority of stakeholders (80% of the respondents) found that MTBFs had contributed effectively to strengthening fiscal discipline. A large proportion of both finance ministries and IFIs assessed effectiveness very positively. The explanations given for weak effectiveness in promoting fiscal discipline relate to:

- (i) existing national provisions allowing for revisions of the MTBF which ultimately can trim down multiannual fiscal planning to one year ahead in the end;
- (ii) the weak anchoring of annual budgets to multiannual fiscal planning;

- (iii) the targets for sub-sectors and the impacts of the envisaged policies not being detailed enough; and
- (iv) lack of clarity as to the roles of the various actors in preparing and approving the MTBF.

Finally, although outside the scope of Directive 2011/85, the prominence of the medium-term dimension in the national fiscal debate and the political commitment to responsible public finances are important drivers of fiscal outcomes. As regards public prominence, practices span from active involvement and sometimes even a vote by the parliament in over half the Member States (which typically gives more weight and visibility to the plans) to a simple presentation by the budgetary authorities preparing the MTBF, with no follow-up expected from the parliament in a third of Member States or simple notification in a minority. In some cases, where the parliament votes on those plans, much less time is allocated than to the annual budget. That discrepancy underlines once more that the dichotomy between annual budgets and medium term budgetary planning is hard to overcome and the two seem to be treated largely as two distinct work streams, in particular where they are adopted at different times (typically in spring for NMTFPs and in autumn for annual budgets). The Member States where political commitment is high, in particular where coalition agreements are signed at the start of a government’s mandate, tend to have more effective MTBFs. However, as important as the above drivers they may be, they are under national sovereignty and thus outside the scope of EU law.

Graph 3.4.8. **Effectiveness of MTBFs in promoting fiscal discipline** (stakeholders’ views)



Notes: The chart shows in percentage points the proportion of MoFs and/or IFIs that gave a rating of 4 or 5 to the issues of relevance and suitability (4/5 meaning relevant/highly relevant, or sufficient/highly sufficient)

Source: Stakeholders survey

3.4.4. Conclusions

Member States' arrangements for medium-term fiscal planning have developed significantly in recent years. This is partly due to the Directive 2011/85, together with other relevant EU drivers such as the preventive arm of the SGP and the two-pack's Regulation 473/2013.

Directive 2011/85 required Member States to establish credible and effective national MTBFs that extend fiscal planning beyond the annual budgetary process, in a comprehensive and transparent manner, while effectively promoting compliance with the EU fiscal framework. To that end, it laid down a number of basic features for the MTBFs: multiannual budgetary objectives covering the whole of general government, multiannual projections of major revenue and expenditure items assuming no policy changes, a description of envisaged medium-term policies (with their budgetary implications) and an assessment of their direct impact on the long-term sustainability of public finances. Directive 2011/85 also established that the annual budget must be prepared on the basis of the revenue and expenditure projections in the MTBF.

Overall, Directive 2011/85 has had a positive impact as regards MTBFs, as Member States have largely incorporated its requirements into their multiannual fiscal planning, but in some respects implementation to date has been unsatisfactory. Currently, all Member States have a more or less developed MTBF that governs the preparation of their medium-term fiscal plans. This can take a variety of forms, e.g. a dedicated piece of legislation, a self-standing domestic document, the SCPs themselves or a combination thereof. More concretely, all Member States' MTBFs contain multiannual objectives for key budgetary aggregates over a period of at least three years. While most Member States provide, in various degrees of detail, projections for general government expenditure and revenue assuming no policy changes, descriptions in the medium-term fiscal plans of envisaged medium-term policies and their budgetary implications by major revenue and expenditure items are often still incomplete or superficial. Furthermore, the assessment of those policies' long-term impact on the sustainability of public finances is often not presented properly, possibly because of Member States having misinterpreted the requirement in Directive 2011/85. While transposing provisions generally require annual budgets to be consistent with the MTBF, their impact on strengthening the link between the annual budget and the medium-term budgetary plans seems to have been limited so far, with a vast majority of stakeholders arguing that consistency has remained unchanged. Finally, more attention needs to be given to having systematic and/or detailed explanations as to why annual budgets have departed from the medium-term fiscal planning projections.

Despite challenges related to medium-term planning, Member State practitioners are positive overall on the added value of the MTBF provisions in Directive 2011/85. Most stakeholders see them either as complementary to the EU rules or consistent with them.

While Directive 2011/85 usefully includes design features that determine the content of MTBFs and establishes that annual budgets should pursue the medium-term fiscal course charted by the MTBF, its impact in terms of making MTBFs genuinely binding has been limited. No provision of Directive 2011/85 prevents Member States from updating their medium-term plans yearly in terms of multiannual objectives and the path towards them, and there is no obligation to explain adjustments between successive

plans, except when a new government takes office. The Directive does not define circumstances that would justify an update or revision of the MTBF in force. While NFRs must be accompanied by independent monitoring and consequences in the event of non-compliance, Directive 2011/85 does not provide for such compliance-enhancing arrangements for the MTBFs. As a result, in spite of the important structural improvements to MTBFs and the greater transparency brought about by Directive 2011/85, annual budgeting remains the dominant driver of fiscal policy choices in most Member States and can still fairly easily override medium-term fiscal plans.⁵⁷

3.5. Coordination mechanisms across sub-sectors of general government

3.5.1. General considerations

Sub-national government sub-sector in the EU

The provisions of the EU budgetary surveillance framework apply to the general government sector as a whole, as defined in ESA2010. The sector is divided into four sub-sectors: central government, state government, local government and social security funds. In terms of expenditure, central government is the largest sub-sector of general government, accounting in a median Member State for 65% of total general government expenditure (in 2018). State and local expenditure accounted for a quarter of total expenditure and social security for 37% (unconsolidated).

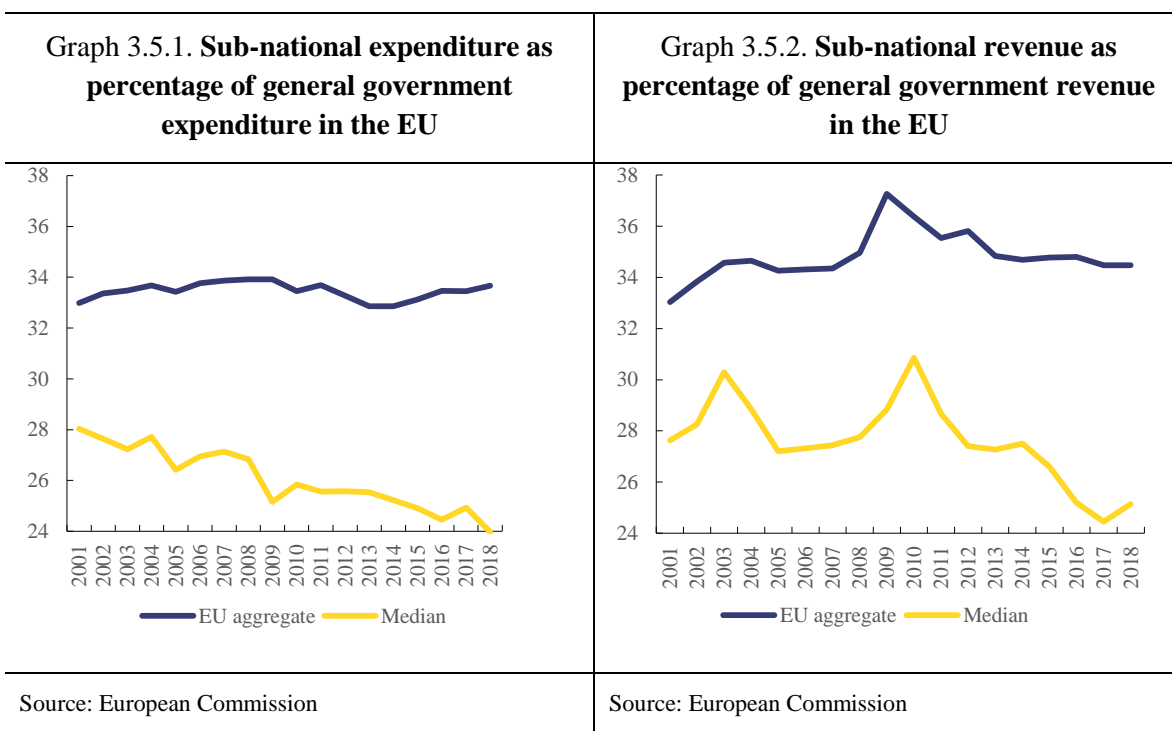
In the Member States, budgetary policy is conducted at various administrative levels. While social security expenditure is statistically separate from central government, social security funds do not usually have expenditure autonomy and are governed by central authorities. It differs from the state government and local government sector, as sub-national authorities, as with central government, also have budgetary powers and implement fiscal policy on their territory in a more or less autonomous way. For that reason, the rest of this chapter focuses on the state and local government and leaves aside the social security funds.

The organisation of budgetary competences in the Member States mirrors the general administrative organisation of the state and varies greatly among them. Multiple factors influence the design of administrative and budgetary structures, such as history, social, political and economic characteristics, size, population, geography, etc. As a consequence, the sub-national government level in the EU is very diverse, with its organisation, structure, role and competences varying significantly among the Member States. In 12 Member States there is one sub-national level of administration, two levels in 11 Member States and three levels in 5 Member States. Additionally, there exist many specific entities, districts etc., with specific roles, functions and competences, which blurs the distinction between individual layers and makes the picture even more complex. Three Member States (Austria, Belgium and Germany) are formally organised as federal in nature. However, although qualified as unitary states, the United Kingdom has some

⁵⁷ In December 2017, the Commission tried to further promote a stronger medium-term orientation in Member States' fiscal policies in its proposal for a Council Directive laying down provisions for strengthening fiscal responsibility and the medium-term budgetary orientation in the Member States, (COM(2017) 824 final).

characteristics of a federal state after the devolution reform in 1997, Italy is considered a ‘regionalised country’ and Spain’s Autonomous Communities (*comunidades autónomas*) are considered statistically within the federal sector as quasi-federated entities.

Over recent decades, until it was interrupted by the latest crisis, Member States saw a visible trend towards the decentralisation of their public finances and reassigned spending responsibilities to lower levels of administration. Public expenditure at sub-national⁵⁸ level in the EU as a whole was an increasing share of general government expenditure up until the beginning of the crisis and reached almost 34% in 2009 (Graph 3.5.1). A more granular look qualifies that picture, as already since 2000 the median Member State has seen – after a steep increase – a steady decline in the share of sub-national public spending. Sub-national revenue (including transfers from central government) seem to have been more stable and fluctuating close to 30% of general government revenue since the early 2000s. Nevertheless, there has also been a steady downward trend since 2010 (Graph 3.5.2).



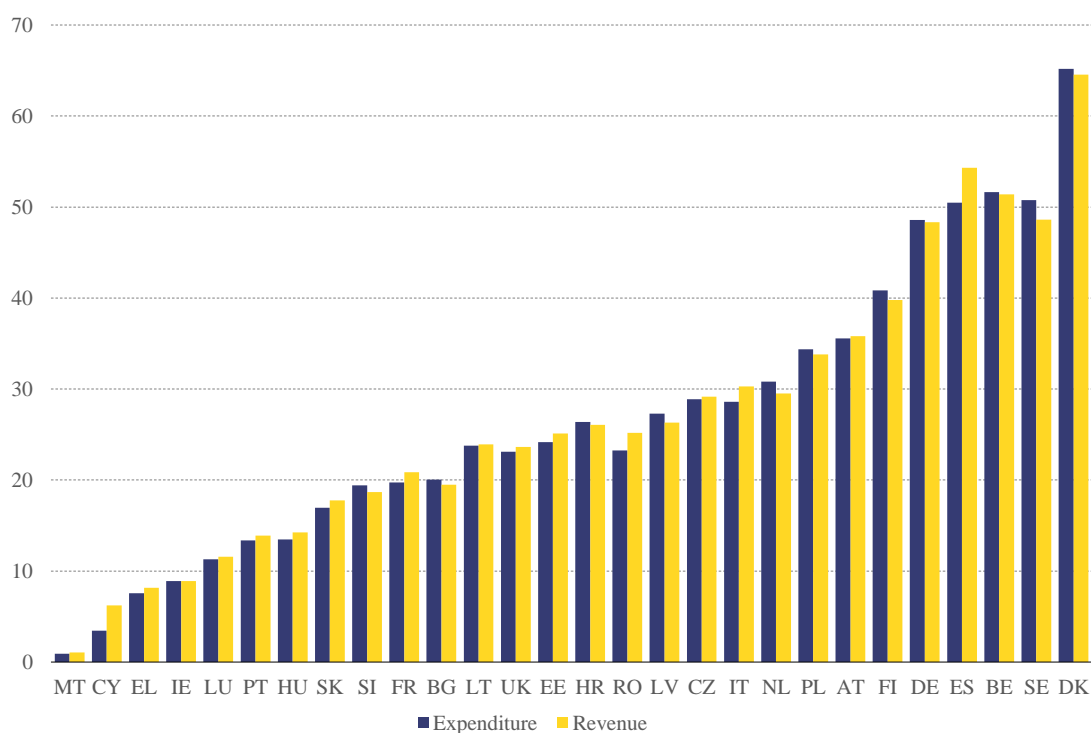
As a result, in 2018 around a quarter of general government expenditure and revenues in the EU was attributed to sub-national authorities (26.6% of expenditure and 24.5% of revenue). Differences among the Member States were very large (GraphGraph 3.5.3). In five Member States (Belgium, Denmark, Germany, Spain, and Sweden), at least around half of general government revenue and expenditure takes place at sub-national level. Denmark stands out as the most decentralised Member State in that

⁵⁸ Unless noted otherwise, the term “sub-national” refers to the local level and the state level. The latter is distinguished in the Eurostat data only in Belgium, Germany, Spain and Austria.

respect with around 65% of both spending and revenue. At the other end of the spectrum, in Malta, Cyprus, Greece and Ireland, sub-national spending and revenue are below 10% of total general government aggregates, with as little as 1% in Malta. Those differences only partly reflect administrative features, such as the division between federal and unitary states, or natural factors such as population size and area.

The economic literature has detected various effects of fiscal decentralisation. On the one hand, it makes it easier to match the provision of public services to heterogeneous consumer preferences and leads to efficiency gains and overall to a smaller government sector. On the other hand, it can create fiscal vulnerabilities, as fiscal discipline is more difficult to enforce at sub-national level (see, for example, Eyraud and Moreno Badia (2013)). Among other things, the literature highlights the nature of decentralisation and fiscal coordination between levels of government as the key factors for budgetary outcomes at general government level (see, for example, *Public Finance Report*, 2012).

Graph 3.5.3. **Sub-national expenditure and revenue as percentage of general government aggregates in Member States (2018)**



Source: Commission

Budgetary policy at sub-national level matters for the entire general government and hence for compliance with EU fiscal rules. As the EU budgetary surveillance framework applies to the general government sector as a whole (as explained above), the conduct of budgetary policy by sub-national authorities and the coordination

arrangements between public authorities at different levels are key components if national budgetary frameworks are to ensure the consistent conduct of fiscal policy at all levels of government and effective application of EU and national fiscal rules.

Requirements of Articles 12 and 13 of Directive 2011/85

Directive 2011/85 requires consistent application of its rules across the sub-sectors of general government. In the light of the above, Article 12 stipulates that the measures provided for by Directive 2011/85 must be consistent across, and comprehensive in the coverage of, all sub-sectors of general government. Also, to ensure good administration, Article 13 stresses the importance of a clear delineation of budgetary responsibilities among government tiers and requires Member States to ‘establish appropriate mechanisms of coordination across sub-sectors of general government to provide for comprehensive and consistent coverage of all sub-sectors of general government in fiscal planning, country-specific numerical fiscal rules, and in the preparation of budgetary forecasts and setting-up of multiannual planning as laid down, in particular, in the multiannual budgetary framework’.

The provisions aim to ensure the consistent and comprehensive inclusion of sub-national authorities in domestic budgetary frameworks. The provisions of Articles 12 and 13 are relatively general, which reflects the large variety of administrative structures in the Member States. However, the provisions are mutually reinforcing. The requirement to ensure consistent coverage of all general government sub-sectors is consistent with and reinforces the requirement to establish coordination mechanisms across sub-sectors. Such mechanisms cannot be expected to function properly if the requirement of Article 13(2) is not duly fulfilled, i.e. sub-sectors’ responsibilities are not clearly defined. These provisions, taken as a whole, require Member States to ensure that every sub-sector, in particular sub-national finances, is an integral part of the national budgetary framework.

The focus of Articles 12 and 13 is clearer in the light of the overall objective of Directive 2011/85. For the purposes of Directive 2011/85, coordination arrangements are mechanisms that ensure consistent policy in the entire general government sector in line with the budgetary obligations stemming from EU law. Therefore, the Directive does not address issues such as the division of tax powers, equalisation arrangements, etc.

3.5.2. Main developments

Any assessment of the suitability of Directive 2011/85’s provisions in this area needs to take account of other developments affecting coordination mechanisms. As in other areas covered by this review, developments external to the Directive or even to EU law influenced the design of Member States’ coordination arrangements. The first such development was the signing of the TSCG, which prompted some Member States to reform their national fiscal frameworks in order to deliver on their commitments made in the Fiscal Compact. Secondly, Regulation No 473/2013 introduced a common budgetary timeline *inter alia* requiring the euro area Member States to present by 15 October each year, besides the draft central government budget, the main parameters of the draft budgets of all other sub-sectors of general government. Similarly, the macroeconomic adjustment programmes, e.g. in Portugal and Greece, contained requirements related to sub-national fiscal frameworks.

Nevertheless, without implying causality, this section presents the main features of coordination arrangements currently in place in the Member States and draws some tentative conclusions as to their appropriateness in the sense envisaged by Directive 2011/85.⁵⁹ In general, one of the most striking features of Member States' coordination arrangements is their diversity, which mirrors the heterogeneous and complex nature of sub-national administrative arrangements. Still, a number of common tools can be distinguished, which are used in order to coordinate budgetary policy across government sub-sectors, such as:

- sub-national fiscal rules;
- the involvement of sub-national authorities in the annual and medium-term budgetary processes; and
- dedicated coordination fora.

Formal sub-national agreements ('national stability pacts') are also distinguished here as a developed form of coordination specific to federal or regionalised countries. These tools are often used in parallel, sometimes reinforcing each other, but also creating a dense web of complex requirements.

a) Sub-national fiscal rules

Sub-national governments are very often subject to rules set out in national legislation⁶⁰ that impose constraints on their finances. These can be considered a tool for 'hard' or 'forced' coordination, as they seek to control the financial position of the sub-national sector and thus its contribution to the general government fiscal stance. These rules apply specifically to local and regional authorities and aim to guide or restrict their fiscal behaviour. The rules considered here are not those rules that apply to general government as a whole, since such rules do not provide useful guidance for individual sub-national authorities.

In 2018, 33 rules applied to sub-national authorities in 18 Member States. In most of those countries, there was a single rule for the sub-national sector, which was applicable to the local governments. The remainder had two to four rules for sub-national entities.

A balanced budget rule was by far the most common type of rule reported (Table 3.5.1). In 2018, there were 23 budget balance rules at local or regional level, including two expressed in structural terms. Six Member States had debt rules, only two had expenditure rules, while none reported any revenue rules for the sub-national sector. Legal bases differed among the Member States, with half the rules enshrined in the national constitution or a law with a strengthened status in the national legal order. One rule, the balanced budget rule for local authorities in Ireland, was based on a political commitment.

⁵⁹ The Fiscal Governance Database and the stakeholders' survey are the main sources of information. They are supplemented by other publicly available information.

⁶⁰ The information provided here does not consider rules that individual sub-national governments could adopt individually for themselves, but only rules applicable to them in a horizontal manner by virtue of national legislation.

Table 3.5.1. **Sub-national fiscal rules in the Member States (2018)**

	Regional government	Local government
Budget balance rule	5	18
Expenditure rule	2	2
Debt rule	1	7
Revenue rule	0	0
Total	8	25

Source: Fiscal Governance Database, European Commission

The strength of rules depends on many different factors and faces specific challenges at sub-national level. The legal basis is only one of the elements relevant for the strength of a rule. Other features include scope for setting or revising objectives, the body in charge of monitoring, enforcement mechanisms and visibility. On the basis of these elements, the Fiscal Governance Database allows us to calculate an index of rule strength. The results show that the strength of sub-national rules does not differ significantly from that of general government rules. However, sub-national rules face a number of specific challenges affecting their effectiveness and strength; these relate to monitoring, specification, enforcement and accountability and stem from the different characteristics of sub-national government as compared to general government, e.g. fragmentation, dependency on transfers from central government, less visible rules, etc.

Many sub-national rules are of a ‘golden rule’ type. This feature of sub-national rules reflects the long-standing practice in the EU of allowing local government borrowing only for capital investment. In fact, apart from the numerical fiscal rules reported in the Fiscal Governance Database, numerous legal and administrative restrictions in the Member States restrict borrowing at sub-national level to investment purposes only.

b) Involvement in the annual budgetary process and medium-term plans

In some Member States, sub-national authorities are not actively involved in the budgetary processes. As the EU fiscal framework requires presentation of budget figures for the entire general government sector, in all Member States the central authorities or institutions (ministries of finance and interior, statistical offices) monitor developments in local finances, including for consolidation purposes. In their budgetary documents, all Member States present information for the whole general government sector. Whereas monitoring and oversight of local finances is necessary for coordination within the general government sector, it cannot be treated as a coordination mechanism *per se*, although many stakeholders see it as such. In around a quarter of Member States this is the sub-national authorities’ only involvement in the budgetary process. These are usually highly centralised Member States where the sub-national sector is a small fraction of general government or sub-national finances are restricted by fiscal rules.

In most Member States, however, central authorities interact with sub-national authorities more actively during the budgetary process. The intensity and type of this involvement vary widely across Member States. This interaction can take the form of regular formal contacts with sub-national authorities, sometimes represented by their associations. Its purpose is most often confined to exchange of information, e.g. the presentation of budgetary objectives and fiscal stance by the central governments and the budgetary situation and plans at sub-national level. For instance, in Latvia the government is required to negotiate with the Association of Local and Regional Governments the issues of interest to the local authorities. A report from these negotiations is attached to the draft budget law and submitted to the parliament. In some (usually small) Member States, even if no formal requirements exist, local authorities are habitually in frequent informal contact with the government. This is the case in Lithuania, for instance, where the authorities report regular contacts with the municipality of Vilnius, by far the biggest, even though there seem to be no formal basis for it.

The sub-national authorities are sometimes also involved in the process of developing the medium-term fiscal plans. The Fiscal Governance Database also collects information on the involvement of sub-national governments in developing the medium-term budgetary plans. Among the 25 Member States for which such data have been collected, almost all report some type of coordination with sub-national authorities in this context. In 11 Member States, this coordination takes place through regular and direct meetings with sub-national authorities or their representatives, but in only half of them are such meetings required by law.

c) Coordination through dedicated coordination fora

Some Member States have further developed the mechanisms of budgetary coordination with sub-national authorities and have created formal dedicated coordination fora for that purpose. This is most often the case in federal and regionalised countries. While the design of these fora is usually straightforward, the complexities of their actual functioning reflect the importance of the political issues they have to deal with. The fora usually have a strong legal base and their role, functioning and mandates are well defined. They are often tasked with more demanding objectives, such as setting fiscal targets and breakdowns among sub-sectors and/or sub-national entities. For instance, in Italy, the coordination with sub-national authorities takes place in three levels of ‘conferences’ between the central and sub-national governments: the Conference of State-Regions, the Conference of State-Municipalities and Local Authorities, and a Unified Conference that includes all the members of the other two conferences.

d) National stability pacts

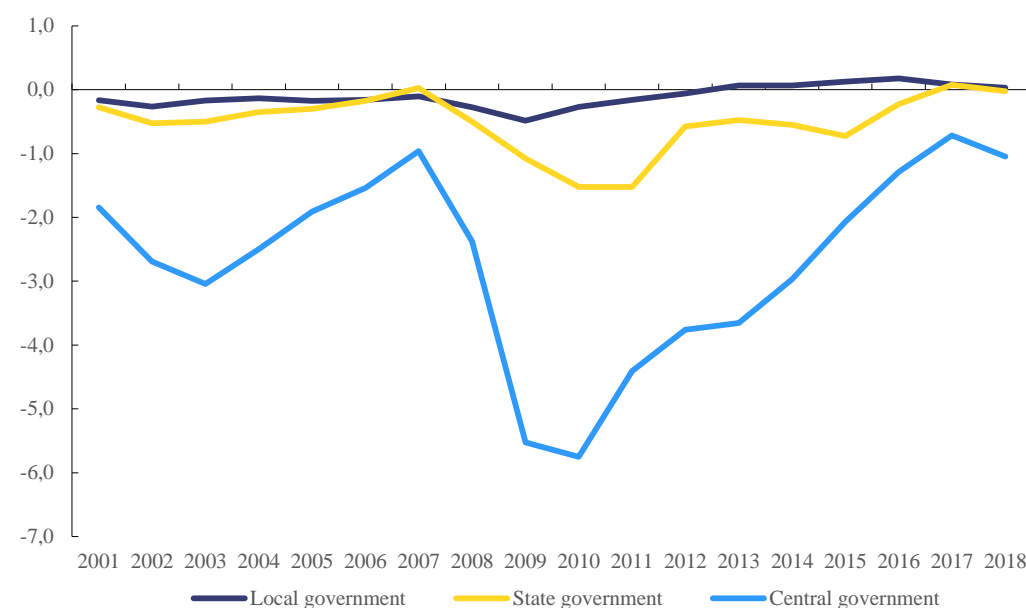
‘Domestic stability pacts’ are probably the most developed form of coordination between government levels. These have been agreed in some federal or regionalised countries (Tournemire, 2014). They constitute formal agreements of a constitutional or quasi-constitutional nature between the independent levels of administration, which are intended to meet fiscal objectives. While the pacts differ in many respects, they usually combine certain common features, such as:

- formal and regular coordination with representatives of government sub-sectors;

- the objective of coordination focusing, but not confined to, the definition of individual fiscal targets for government sub-sectors;
- joint monitoring based on agreed indicators; and
- corrective procedures.

The broad nature of the provisions of Directive 2011/85 on coordination mechanisms allows the Member States to maintain their various arrangements, provided they are ‘appropriate’. The Member States can preserve the specific characteristics of their coordination arrangements, tailored to local conditions and national preferences. While Directive 2011/85 accommodates this variety, it still requires that the coordinating mechanisms be ‘appropriate’. The general nature of this requirement and the variety of coordination arrangements make it difficult to assess their appropriateness. However, taking into account the overall objectives of Directive 2011/85, one could reasonably consider as ‘appropriate mechanisms’ those which effectively ensure that the sub-national entities contribute to achieving a Member State’s fiscal policy objectives in line with the SGP requirements. From this perspective, an attempt can be made to gauge tentatively the ‘appropriateness’ of the coordination mechanisms using two approaches.

Graph 3.5.4. **Fiscal balances by sub-sector of the general government, Member States (% of GDP)**



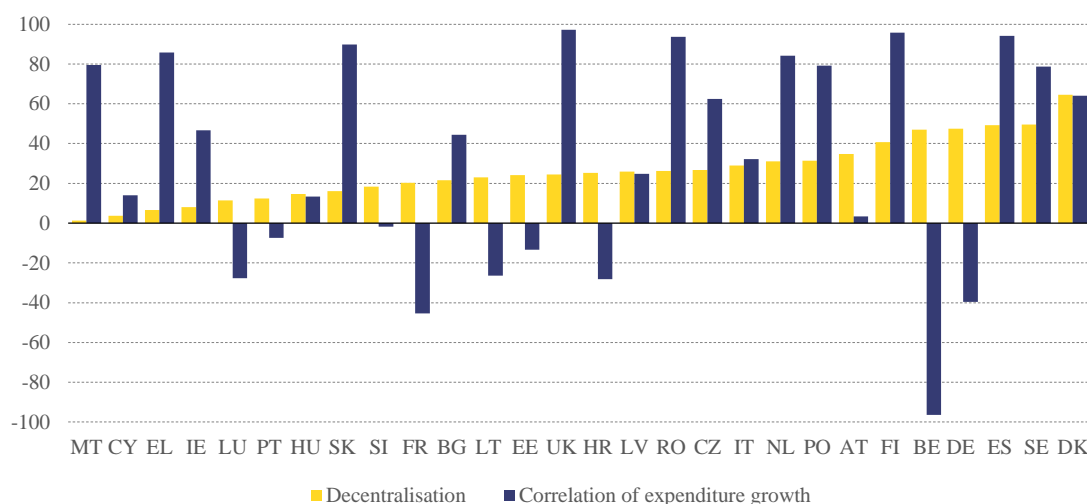
Notes: Nominal balance (net lending/net borrowing) in government sub-sectors, simple average across EU Member States.

Source: European Commission

A first approach would look at the contribution of the sub-national sector to the budgetary discipline of general government. From this perspective, the assessment should overall be positive: the financial position of sub-national authorities has been significantly better than that of general government as a whole (Graph 3.5.4). This is the

case for the local governments, in particular, where the position has been broadly balanced. The difference in the development of deficits at the sub-national and general government levels also reflects different fiscal policy objectives. In particular, the large central government deficit during the crisis is the outcome of the macroeconomic stabilisation policy, which is normally (and in line with economic theory) allocated to the central level. Also, a large part of sub-national revenue comes from transfers from central government, mostly in the form of grants.

Graph 3.5.5. **Decentralisation of expenditure and correlation of expenditure growth between the central and local government, Member States**



Notes: Decentralisation measured as the share of sub-national expenditure in total general government expenditure. Correlation measured as a 5-year rolling window correlation coefficient, multiplied by 100, between growth of expenditure at the central government and at the sub-national level.

Source: European Commission

The second approach to assessing the appropriateness of coordination arrangements would take as starting point the notion of coordination. This approach would start from the premise that the arrangements are meant to coordinate budgetary policies across sub-sectors, with the central level giving the overall orientation of the general government policy stance. From this perspective, Graph 3.5.5 shows the correlation of sub-national and central government expenditure growth and sets it against the level of spending decentralisation. The intuition behind this approach is that a country with a high level of decentralisation would require better coordination mechanisms in order to ensure consistent implementation of budgetary policy and hence should show higher correlation between the policy implemented at the central and the sub-national levels. In a country where the share of sub-national expenditure is small, a heterogeneous policy at the sub-national level does not create risks for general government and the emphasis on coordination arrangements is less crucial. A caveat here is that the correlation of expenditure growth is only a crude measure of the efficiency of coordination, as coordination can have various objectives, not only aligning policy stances. Nevertheless, the picture in Graph 3.5.5 is also positive, as in the most diversified Member States the growth of central and sub-national government

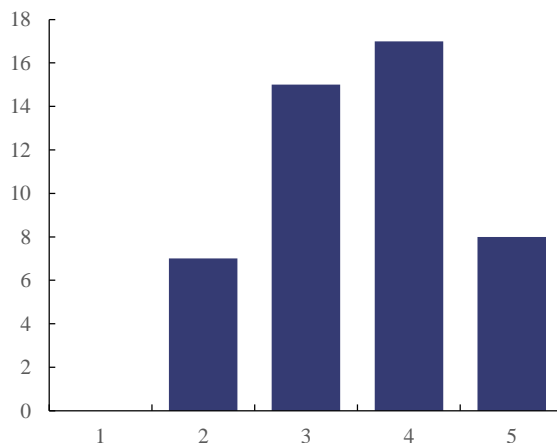
expenditure was highly correlated.⁶¹ It should be also flagged that the stakeholders themselves assess the general effectiveness of the coordination mechanisms in their Member State as medium-high (Graph 3.5.6).

Directive 2011/85 could influence the design of the coordination arrangements to a limited extent only. Beyond the above brief overview of coordination mechanisms currently in place, the question remains, as flagged above, as to the extent to which the Directive has influenced their existence and design. It is rather unlikely that the influence has been large, given in particular:

- the need for the coordination arrangements to reflect the general organisation of the state and hence their constitutional nature;
- the relatively general and unspecific nature of the requirements of Articles 12 and 13 (which is to some extent the natural outcome of the first factor); and
- also related, the fact that the coordination arrangements had been in place before Directive 2011/85, although several reforms have been implemented since its adoption.

While some stakeholders flagged the general nature of the provisions as a weakness, they in general consider that the provisions bring relatively high added value, that they add to existing EU provisions in this area and that they have been effective in supporting fiscal discipline in line with the SGP (see Annex for more details).

Graph 3.5.6. **Effectiveness of coordination arrangements across government sub-sectors** (stakeholders' views)



Notes: Stakeholders' answer to the question 'How would you rate the effectiveness of the coordination arrangements in your country between 1 (not effective) and 5 (very effective).'

⁶¹ The outlier position of Belgium stems from the federalism reform and a secular trend towards increasing sub-national and decreasing federal expenditure.

3.5.3. Conclusions

All Member States now have provisions reflecting the requirements of Articles 12 and 13. In other words, all Member States' fiscal frameworks cover all sub-sectors of general government and mechanisms exist to ensure budgetary coordination across sub-sectors. This is a basic requirement to ensure that the whole general government sector contributes to achieving the domestic fiscal objectives and, ultimately, compliance with the EU budgetary rules, which is the aim of Directive 2011/85. It is less straightforward to judge whether these mechanisms are 'appropriate', as required by Directive 2011/85, but there is some evidence pointing in this direction. It is less certain that the Directive has had a significant role in incentivising Member States to create or upgrade their coordination mechanisms, which are heavily influenced by their general administrative organisation and the constitutional competences of the various administrative levels.

4. OVERALL ASSESSMENT AND CONCLUSIONS

Since the adoption of Directive 2011/85, Member States' budgetary frameworks have seen rapid and broad-based development. There are stronger budgetary frameworks in all areas covered by it. Progress has been more visible in those Member States that had no or only basic domestic frameworks before, and Directive 2011/85 provided the basis for building their national frameworks.

Directive 2011/85 has been part of a worldwide trend towards strengthening budgetary frameworks. Wide-ranging reforms of national fiscal frameworks have also been taking place outside the EU. The 'EU model' of promoting rule-based fiscal frameworks has for some time been the default reference for countries wishing to strengthen domestic frameworks and make them more effective in ensuring fiscal discipline and sustainability. Recent economic research provides empirical evidence of the greater effectiveness of comprehensive frameworks in which fiscal rules are accompanied by independent monitoring arrangements (as mandated by the Directive) and embedded in medium-term frameworks (see e.g. Eyraud *et al.* 2018).

The above analysis of developments in the various areas of budgetary frameworks since the adoption of the Directive reveals strong progress in general, but several areas are worth highlighting:

- *national numerical fiscal rules*, which have grown visibly in number and strength across the EU and are now a key component of domestic frameworks in all Member States. While the adoption of many new rules created a fairly complex environment, there are indications that the rules are effective overall and promote compliance with EU fiscal rules. The design requirements of Directive 2011/85 have contributed to that outcome;
- *medium-term fiscal planning*, where Directive 2011/85 has introduced a number of specific requirements that have expanded the content and improved the transparency of national MTBFs with a view to enhancing their role as a medium-term anchor of fiscal policy;
- *fiscal statistics*, where Directive 2011/85 has triggered the production and publication of new streams of data, leading to tangibly improved fiscal

transparency. The success related to contingent liabilities is a very good example of how Directive 2011/85 has led to the creation of a new stream of public information that significantly improves the monitoring of fiscal risks in the EU;

- there are indications that the reliability of *forecasts* and the transparency of the forecasting process have improved.

The analysis also highlights instances where Directive 2011/85 has so far been less successful in achieving the envisaged results, in particular:

- the mere transposition of its provisions on *medium-term budgetary frameworks* has generally not been enough to give medium-term fiscal planning a more important role in the budgetary process. The MTBFs are still to an overly large extent subordinate to the annual budget processes and do not create a sufficiently stable and credible medium-term perspective for fiscal policy;
- not all *fiscal rules* in the Member States are well specified and equipped with strong compliance safeguards. In particular, there is considerable scope to improve them as regards defining the consequences of non-compliance and independent monitoring;
- as far as *statistics and transparency* are concerned, the usefulness of high-frequency statistics has been rather disappointing and the published information on tax expenditures or extra-budgetary bodies and funds is too varied. Also, the use of public accounting is constrained by the lack of a common European benchmark to support comparability, although many Member States have shown a greater willingness to modernise their public sector accounting;
- the implementation of the requirement of *ex-post forecast evaluation* has been unsatisfactory, possibly related to differences in interpreting that requirement in Directive 2011/85.

The surveyed stakeholders have in general very positive views on Directive 2011/85.

There is overwhelming agreement that a strong domestic fiscal framework effectively promotes fiscal discipline and ensures compliance with EU fiscal rules. Directive 2011/85 is also considered to have been effective in contributing to the achievement of fiscal discipline in line with the SGP. ‘Strengthening ownership’ of fiscal discipline and of EU fiscal rules is one of its objectives and stakeholders consider that Directive 2011/85 has been relatively effective in meeting it. This has been almost entirely due greater awareness of fiscal discipline among policy-makers while Directive 2011/85 is not considered to have been successful in raising awareness among the general public. The stakeholders also see high added-value in having certain minimum EU standards for domestic fiscal frameworks and the objectives of Directive 2011/85 continue to be seen as relevant. Overall, stakeholders rate Directive 2011/85 as highly suitable.

Directive 2011/85 has promoted a balanced and comprehensive development of domestic budgetary frameworks. Even if it cannot be directly credited for triggering all the reforms, as other EU-level law and intergovernmental initiatives were taken in parallel (in particular the TSCG and Regulation No 473/2013), it has been a major contributor to improvements in domestic frameworks across the EU. Unlike those other initiatives, which touched *inter alia* on specific aspects of the budgetary framework, the Directive introduced a set of comprehensive requirements covering the entire domestic

budgetary framework, leading to the overall balanced development of budgetary frameworks in all its aspects. Practice shows that fiscal frameworks function as connected systems and the harmonious development of, and interaction among, all its components produce the best results. In spite of many other factors shaping developments in domestic budgetary frameworks, stakeholders credit Directive 2011/85 with a relatively high influence on their national frameworks. Even so, the European Court of Auditors, after reviewing the EU provisions on national fiscal budgetary frameworks, sees a need for their further strengthening and better monitoring.⁶² In contrast to the other initiatives taken in the wake of the crisis to reinforce the EU fiscal framework, Directive 2011/85 did not establish new substantive rules or enforcement mechanisms. Rather, it sought to strengthen the underlying domestic infrastructure for the application of the common fiscal rules, or domestic fiscal policy overall. As such, it has largely escaped the controversies about the state of the EU fiscal framework and the desirable direction of change, and it appears to enjoy a higher degree of across-the-board support than the rest of the framework.

⁶² European Court of Auditors (2019), “EU requirements for national budgetary frameworks: need to further strengthen them and to better monitor their application. Special Report 22/2019.”

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5. ANNEX: STAKEHOLDERS SURVEY

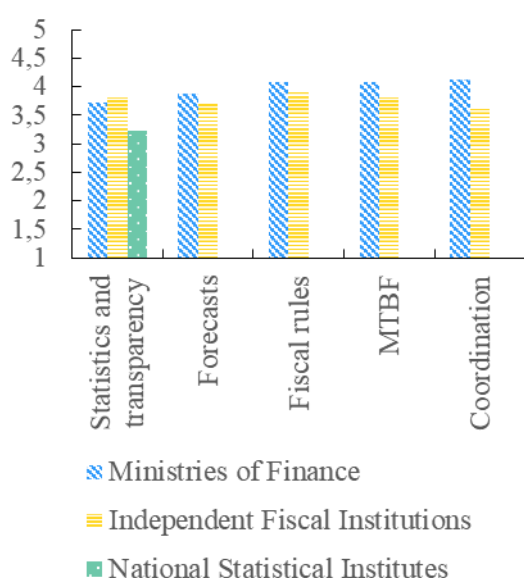
For the purposes of this review, the Commission conducted surveys of the main stakeholders, i.e. the Member States' finance ministries, national statistical institutes and IFIs. The internet-based surveys contained factual questions on the stakeholders' domestic budgetary frameworks and questions aimed at gauging their opinions on various aspects of the Directive. To gain further insights into their views, the preliminary results of the surveys were discussed and broadly confirmed with the stakeholders in two meetings:

- a dedicated workshop with the finance ministries and the IFIs (Brussels, 4 July 2018); and
- discussions with the national statistical offices in a meeting of the Sub-Committee on Statistics of the Economic and Financial Committee (Brussels, 15 June 2018).

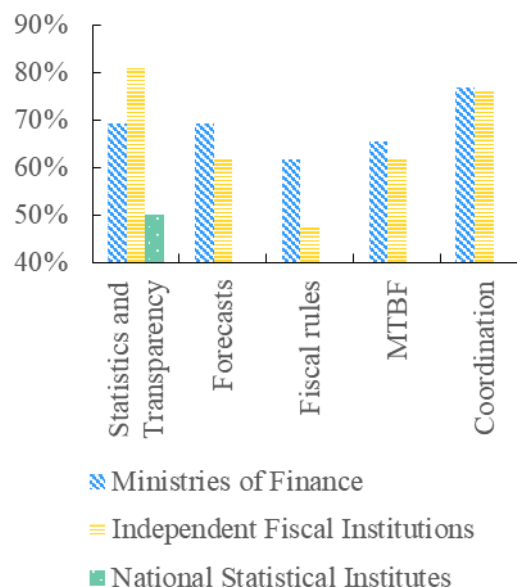
The surveys were sent out to all 28 finance ministries, 28 IFIs and 28 statistical offices. Answers were received from 26 ministries (25 answered the survey on the statistics part of Directive 2011/85), 21 IFIs and 26 statistical offices, i.e. a response ratio of 75-93% depending on the survey. The stakeholders workshop was attended by representatives of 23 ministries and 20 IFIs, while in the meeting of the Sub-Committee on Statistics all Member States were represented by delegates from their finance ministry and statistical office, as per the statutes of the Sub-Committee.

A summary of the answers to the main evaluation questions of the survey is presented below.

Graph A1. How would you rate the effectiveness of the provisions of the respective sections in supporting fiscal discipline in line with the SGP?

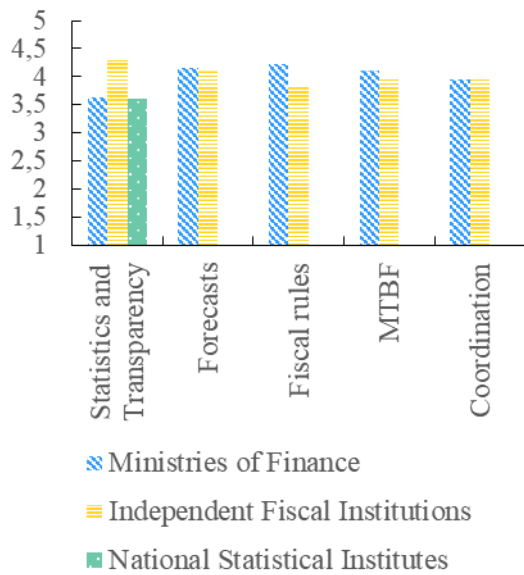


Graph A2. The share of respondents considering provisions as complementary to other relevant EU-level requirements



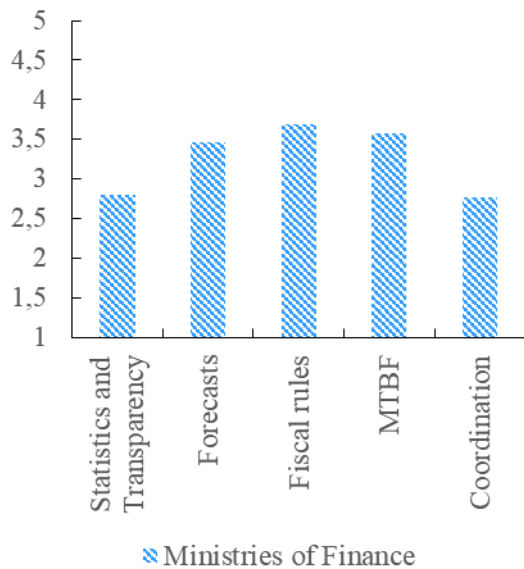
Notes: answers range from 1 (very ineffective) to 5 (very effective). Average is shown.

Graph A3. What is the value added of having certain minimum standards across the EU for this section?



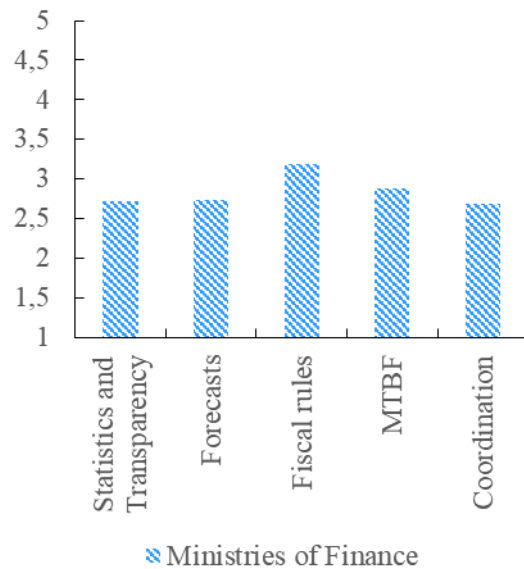
Notes: answers range from 1 (low value added) to 5 (high value added). Average is shown.

Graph A4. How would you assess the extent of legal and procedural changes in relation to this section required in your country by the transposition of the Directive?



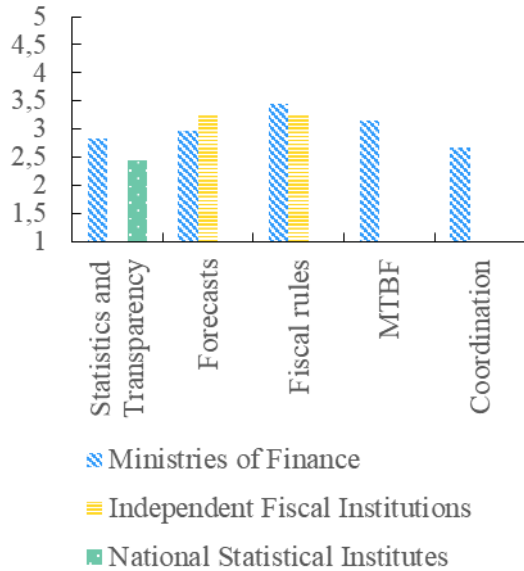
Notes: answers range from 1 (insignificant changes) to 5 (significant changes). Average is shown.

Graph A5. How would you assess the extent to which the transposition of the provisions referred to in this section was challenging in your country?



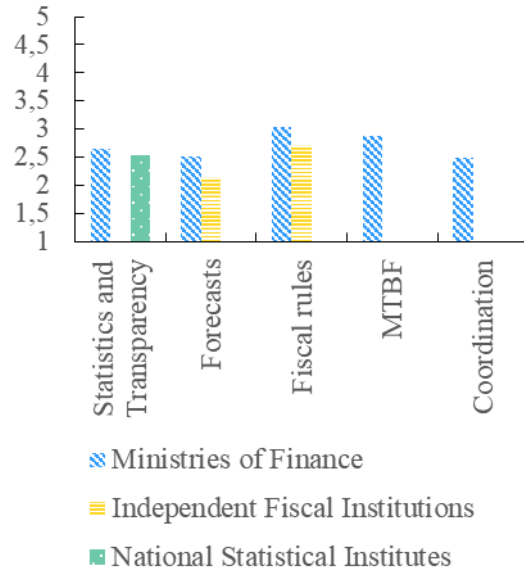
Notes: answers range from 1 (not challenging) to 5 (very challenging). Average is shown.

Graph A6. How would you assess the extent of changes (e.g. in terms of procedures, practices, documents, data, etc.) in relation to this section required by the implementation of the Directive in your country?



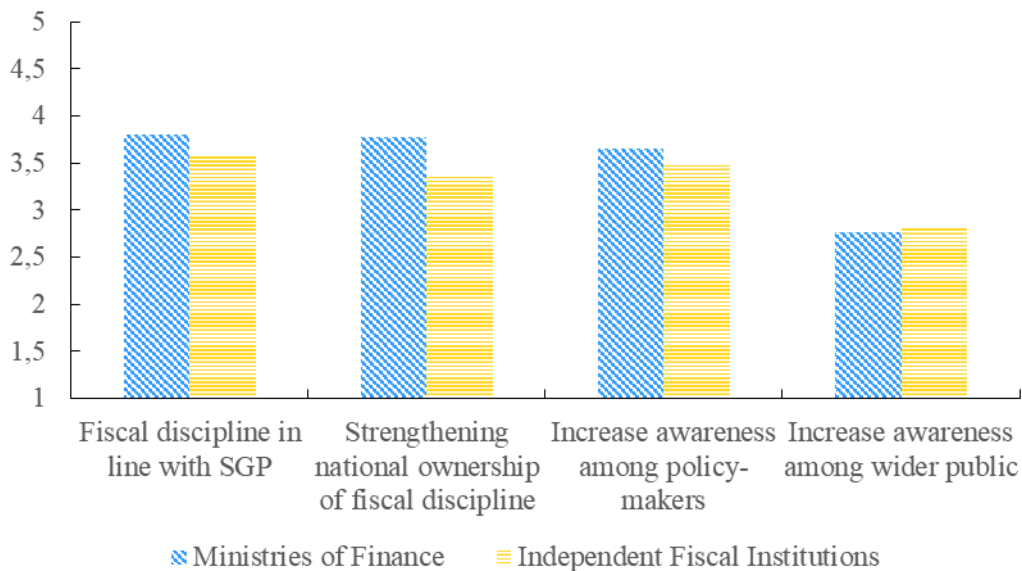
Notes: answers range from 1 (insignificant changes) to 5 (significant changes). Average is shown.

Graph A7. How would you rate the difficulty to implement in your country the provisions referred to in this section?



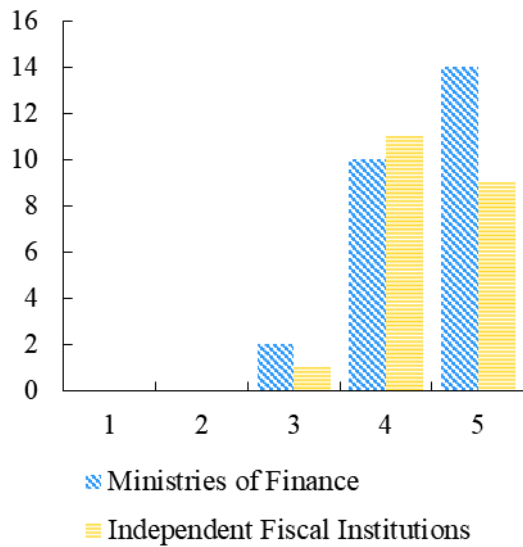
Notes: answers range from 1 (not difficult) to 5 (very effective). Average is shown.

Graph A8. To what extent has the Directive been effective in contributing to...



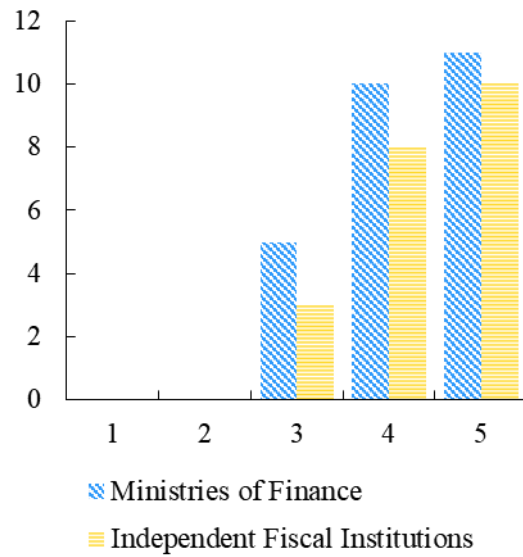
Notes: answers range from 1 (very ineffective) to 5 (very effective). Average is shown.

Graph A9. Is a strong domestic fiscal framework an effective method to promote fiscal discipline and ensure compliance with the EU fiscal rules?



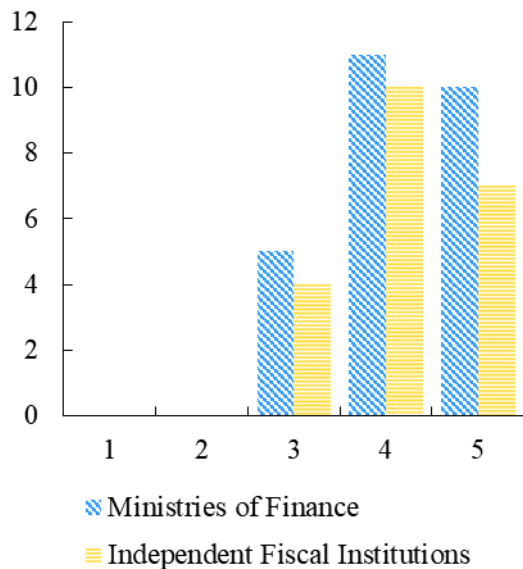
Note: answers range from 1 (very ineffective) to 5 (very effective).

Graph A10. Are the objectives of the Directive still relevant?



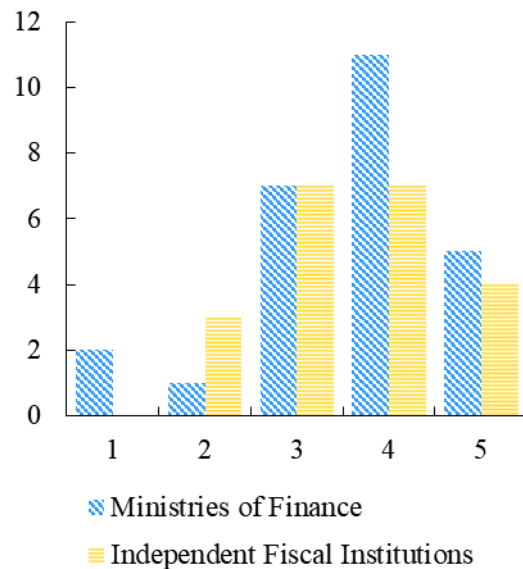
Note: answers range from 1 (not relevant) to 5 (very relevant).

Graph A11. What is the value added of having certain minimum standards across the EU for domestic fiscal frameworks?



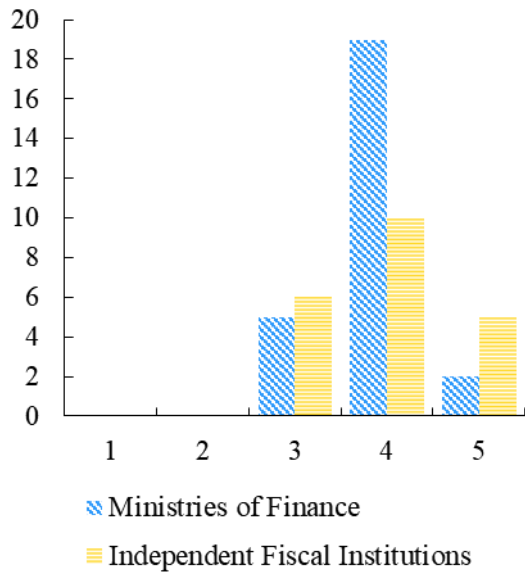
Note: answers range from 1 (low value added) to 5 (high value added).

Graph A12. How would you rate the extent to which the Directive has influenced the development of your country's fiscal framework?



Note: answers range from 1 (no influence) to 5 (has influenced very much).

Graph A13. Overall, how would you assess the suitability of the provisions in the Directive?



Note: answers range from 1 (not suitable) to 5 (very suitable).