



OPINION OF THE EUROPEAN CENTRAL BANK
of 18 December 2013
on public finances
(CON/2013/90)

Introduction and legal basis

On 12 July 2013, the European Central Bank (ECB) received a request from the Luxembourg Ministry of Finance for an opinion on a draft law on coordination and governance of public finances¹ (hereinafter the ‘draft law’).

The ECB’s competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third indent of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions², as the draft law relates to the Banque centrale du Luxembourg (BCL). In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

- 1.1 The main purpose of the draft law is to improve Luxembourg’s legislation on public finances and budgetary framework in the light of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union³ (hereinafter the ‘TSCG’), 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 in the Member States in the euro area⁴ and Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States⁵. The draft law is scheduled to enter into force on 1 January 2014.
- 1.2 To this end, the draft law aims at reflecting the requirements laid down in Article 3(1) of the TSCG in respect of central and local government, as well as social security fund sub-sectors. These are, *inter alia*, that the budgetary position of the general government of a contracting party to the TSCG

¹ The full title of the draft law is ‘Law on the coordination and governance of public finances, amending the amended Law of 8 June 1999 on budget, accounting and treasury as well as the amended Law of 10 March 1969 setting up a general inspection of the public finances’.

² OJ L 189, 3.7.1998, p. 42.

³ The TSCG was signed by 25 Member States on 2 March 2012. It entered into force on 1 January 2013, on the basis that 12 euro area Member States had deposited their ratification instruments by that date.

⁴ OJ L 140, 27.05.2013, p. 11.

⁵ OJ L 306, 23.11.2011, p. 41.

shall be balanced or in surplus, and supported by a medium-term budgetary objective and an adjustment path, as well as a correction mechanism to be automatically triggered in case of significant deviation from the medium-term objective or the adjustment path towards it.

- 1.3 The BCL, without prejudice to its own tasks, will be entrusted with the tasks of monitoring compliance at national level with the abovementioned requirements, assessing macroeconomic and budgetary forecasts established for the purpose of general government fiscal planning, as well as conducting all other assessments required under Article 5(2) of Regulation (EU) No 473/2013.
- 1.4 In order to make Luxembourg's legislation on public finances compliant with the abovementioned requirements and to implement Directive 2011/85/EU, the draft law establishes that the medium-term objective and adjustment path towards it be laid down in the multiannual financial planning law. This will cover the same period as the subsequent update of the stability and growth programme. In addition, the amended Law of 8 June 1999 on budget, accounting and treasury (hereinafter 'the Budget Law')⁶ will be further amended, with the effect that a budgetary procedure would enter into force if Parliament does not approve the national budget by 1 January of the year to which the budget applies.

2. General observations

- 2.1 In accordance with Article 2(1) of Council Decision 98/415/EC, the relevant Member State authorities shall consult the ECB on any draft legislative provision within the latter's field of competence pursuant to the Treaty, unless the exclusive purpose of such provisions is the transposition of Union legal acts into Member States' national laws. The Luxembourg Ministry of Finance has accordingly sought the ECB's opinion on the draft law, which, in the context of the implementation of the TSCG and of certain provisions of Directive 2011/85/EU and Regulation (EU) No 473/2013, entrusts the BCL with new tasks and amends the Budget Law. The ECB welcomes the opportunity to give its opinion on this draft law, which aims to improve the national budgetary framework in terms of consistency with the reinforced Union governance framework and the sustainability of public finances.
- 2.2 Although Luxembourg is not subject to an excessive deficit procedure, enactment of the draft law is of the utmost importance in the light of the structural fiscal challenges it faces⁷ and of the urgent need to modernise its legal budgetary framework, which is still based on an annual budget exercise.

3. Form of implementation of the balanced budget rule and correction mechanism

- 3.1 Article 3(2) of the TSCG provides that the 'balanced budget rule' takes effect in national law through 'provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary

⁶ Mémorial, 11.06.1999, A, No. 68, p. 1448.

⁷ See the BCL opinions on the draft budgetary laws in respect of the years from 2008 to 2012 inclusive, available on the BCL's website at www.bcl.lu.

processes'. In accordance with the Communication from the Commission on Common principles on national fiscal correction mechanisms (hereinafter the 'Common Principles')⁸ adopted in accordance with Article 3(2) of the TSCG, the legal status of the correction mechanism to be triggered in case of significant observed deviations⁹, 'should be such that their provisions cannot be simply altered by budgetary law'.

- 3.2 The ECB notes that the draft law has been designed as an ordinary legal act, which could be deviated from by any other ordinary law (including any budget laws). The ECB invites the consulting authorities to reconsider the form of the national legal act implementing the TSCG since the mere enactment of the draft law, while constituting a timely and necessary step towards implementing the TSCG, does not guarantee the primacy of the rule laid down in Article 3(1) of the TSCG in Luxembourg's legal system. A possible way forward that the Luxembourg authorities may want to consider is to reflect the principle of a balanced budget in the Luxembourg Constitution.

4. The nature of the correction mechanisms

- 4.1 Article 3(1)(e) of the TSCG requires the automatic triggering of a correction mechanism in the event of significant observed deviations from the medium-term objective or the adjustment path towards it. This correction mechanism shall include the obligation to implement measures to correct the deviations over a defined period of time. Common Principle 4 further provides that pre-determined rules shall frame the size and timeline of the correction, thereby limiting, though not entirely ruling out, the scope for discretion in devising the response to a significant budgetary deviation. In addition, a Member State is expected to restore the medium-term objective as fast as is reasonably possible, which generally means either in the year immediately following the occurrence of the deviation or the subsequent year.
- 4.2 While the draft law improves the medium-term budgetary framework in line with the requirements of the TSCG, the mechanism for correcting observed deviations lacks automaticity. Moreover, the draft law does not sufficiently detail the specificities of the correction mechanism. In particular, Article 6 of the draft law specifies only that the government shall include measures to re-establish the path provided for in the multiannual planning law, no later than in the draft budget for the coming year. In this context, it would be useful for the Luxembourg legislator to consider adopting a more stringent deadline for taking corrective measures, by which the pace of implementation would be quickened and the automaticity of the mechanism would be strengthened. Furthermore, the draft law fails to specify the nature of the measures to be taken and leaves it to the government's discretion, which is not in line with the abovementioned provisions of the TSCG and Common Principle 4. Effective coordination across the different sublevels of government might be considered to achieve this purpose.

⁸ COM(2012) 342 final.

⁹ See Article 3(1)(e) of the TSCG.

5. Assumption of new tasks by the BCL

- 5.1 The draft law entrusts the BCL with new tasks: it designates the BCL as the independent institution monitoring compliance with Article 3(1) of the TSCG, and makes it responsible for assessing macroeconomic forecasts for the purpose of general government fiscal planning and for conducting all other assessments pursuant to Article 5(2) of Regulation (EU) No 473/2013. These new tasks are not provided for in the Law of 23 December 1998 on monetary status and on the Banque centrale du Luxembourg¹⁰ (hereinafter the ‘BCL Law’).
- 5.2 Without prejudice to the Governing Council’s powers under Article 14.4 of the Statute of the European System of Central Banks (hereinafter the ‘Statute of the ESCB’), national central banks (NCBs) may perform functions other than those specified in the Statute of the ESCB provided that such functions do not interfere with the objectives and tasks of the ESCB and do not infringe upon the independent execution by the NCB of its ESCB tasks¹¹.
- 5.3 The BCL role provided for in the draft law pursuant to Article 3.2 of the TSCG would imply, in accordance with Common Principle 7, that the BCL, in order to support the credibility and transparency of the correction mechanism, would monitor compliance with the numerical fiscal rules incorporated in the national budgetary processes, as well as with the medium-term budgetary objectives included in the multiannual financial planning and provide public assessments with regard to: (a) the occurrence of circumstances warranting the activation of the correction mechanism; (b) whether the correction is proceeding in accordance with national rules and plans; (c) the occurrence of circumstances for triggering, extending and exiting escape clauses. Similarly, the BCL’s role provided for in the draft law pursuant to Article 5(2) of Regulation (EU) No 473/2013 would imply that the BCL, in addition to monitoring compliance with the fiscal rules identified in this Article, must provide assessments, *inter alia*, on fiscal matters broadly equal to those contained in Common Principle 7¹². Furthermore, the draft law gives a general responsibility to the BCL to assess macroeconomic and budgetary forecasts established for the purpose of general government fiscal planning.
- 5.4 It is acknowledged that an NCB commonly monitors various types of information in order to properly assess current and prospective developments that are relevant for monetary policy. Monitoring fiscal developments is a task that an NCB carries out on a regular basis in order to properly assess the stance to be taken in monetary policy. Moreover, NCBs may present their views on relevant fiscal developments on the basis of their monitoring activity and the independence of

¹⁰ *Mémorial*, 24.12.1998, A, No 112, p. 2980.

¹¹ See paragraph 2 of Opinion CON/2013/56.

¹² According to Article 5(2), these assessments would cover ‘(a) the occurrence of circumstances leading to the activation of the correction mechanism for cases of significant observed deviation from the medium-term objective or the adjustment path towards it in accordance with Article 6(2) of Regulation (EC) No 1466/97; (b) whether the budgetary correction is proceeding in accordance with national rules and plans; (c) any occurrence or cessation of circumstances referred to in the tenth subparagraph of Article 5(1) of Regulation (EC) No 1466/97, which may allow a temporary deviation from the medium-term budgetary objective or the adjustment path towards it, provided that such a deviation does not endanger fiscal sustainability in the medium term’.

their advice, with a view to also contributing to the proper functioning of European Monetary Union. In this respect, the monitoring of fiscal developments by Eurosystem central banks for monetary policy purposes should be based on the full access to all relevant public finance data. Accordingly, the BCL should be granted unconditional, timely and automatic access to all relevant public finance statistics. The BCL's current role in monitoring fiscal developments should be enhanced through obtaining unconditional, timely and automatic access to all relevant public finance statistics. In any event, the BCL should retain any role it may already have regarding the production and quality control of government finance statistics in accordance with Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community¹³, Guideline ECB/2013/23 on government finance statistics, and the memorandum of understanding on the cooperation between the members of the European Statistical System (ESS) and the members of the ESCB, dated 24 April 2013¹⁴.

- 5.5 However, as indicated by the ECB in a recent opinion, an NCB's role should not go beyond monitoring activities that result from or are linked – directly or indirectly – to the discharge of their monetary policy mandate¹⁵. The ECB is of the view that the monetary policy mandate as well as an NCB's independence run the risk of being undermined if the NCB takes up the monitoring activities set out in Article 5 of Regulation (EU) No 473/2013 and Article 4 of Directive 2011/85/EU. This would likely pose risks to the discharge of its monetary policy mandate, *inter alia*, for the following reasons. First, as regards involvement in macro-economic forecasting in accordance with Directive 2011/85/EU, an NCB could become subject to guidelines or scrutiny by national or European authorities under Article 4(5) of Directive 2011/85/EU¹⁶. As a result, an NCB might be required to disclose its view of the economic outlook according to principles and/or a schedule different from that for publishing the economic projection it deems relevant for monetary policy purposes. This would represent an impairment of the independence of the NCB. Second, as regards the provision of assessments of fiscal policy¹⁷, the formal mandate to scrutinise government policies in the form of public opinions would put the NCB in a position that could regularly conflict with fiscal policy-making. The economic assessment of fiscal and macroeconomic developments is never entirely mechanical and always contains an element of judgement. It is thus easily subject to political controversy. This, in turn, could affect the working relations between the NCB and the government, affect the public perception of the NCB as well as possibly undermine

¹³ OJ L 145, 10.06.2009, p. 1.

¹⁴ Available on www.ecb.europa.eu. The Memorandum of Understanding facilitates close cooperation between the ESS and the ESCB in areas of shared responsibility or common interest, thereby increasing the potential synergies in the production *inter alia* of government finance statistics.

¹⁵ See paragraph 4.3 of Opinion CON/2012/105.

¹⁶ See also the Specifications on the implementation of the 'two-pack' and Guidelines on the format, content of draft budgetary plans, economic partnership programmes and debt issuance reports of 1 July 2013 (hereinafter the 'Specifications'). Available on the European Commission website at www.ec.europa.eu.

¹⁷ Particularly those provisions relating, *inter alia*, to circumstances arising that lead to the activation of the correction mechanism, the budgetary correction and medium-term objectives or adjustment path deviations. It also includes considerations provided for in the escape clause according to which the deviation from the balanced budget rule may surpass the anticipated limit in the case of extraordinary circumstances.

its independence. More generally, a formal mandate for an NCB to assess forecasts and fiscal developments implies a function for the NCB in the fiscal policymaking process. As an NCB is thus entrusted with a share of the responsibility for fiscal policy, the institutional separation between fiscal and monetary policy becomes blurred.

- 5.6 The ECB therefore recommends that the consulting authority reconsiders the assignment by the draft law of the new tasks to the BCL. In this context, the ECB reiterates that the Specifications recommend the preparation of an all-encompassing code of practice, gathering all the relevant legal provisions and procedural elements that are part of the framework for the production and/or endorsement of independent macro-economic forecasts¹⁸, including the timely provision of forecasts to support the relevant stages of the national budgetary process. In addition, the ECB notes that the institution(s) responsible for preparing, producing, monitoring and analysing the macroeconomic forecasts are to be designated by means of a grand-ducal regulation only after the draft law comes into force¹⁹. The draft law and the grand-ducal regulation would therefore need to separate the responsibilities between the government, which is exclusively competent for compliance with the TSCG and Regulation (EU) No 473/2013, and the central bank, which should not go beyond what is necessary for monetary policy purposes as regards fiscal policy monitoring.

6. Financial independence of the BCL and prohibition of monetary financing

- 6.1 Without prejudice to the observations on the new tasks entrusted to the BCL by the draft law as concerns the BCL's discharge of its existing monetary policy tasks, the ECB reiterates that, from an operational and financial point of view, any new task allocated to an NCB should not affect that NCB's ability to carry out its ESCB-related tasks. Financial independence, which is an element of the principle of central bank independence referred to in Article 130 of the Treaty, requires an NCB to have sufficient means not only to perform its ESCB-related or Eurosystem-related tasks but also its national tasks, e.g. financing its own administration and operations. Such financial independence is assessed from the perspective of whether any third party is able to exercise either direct or indirect influence not only over an NCB's tasks, but also over its ability to fulfil its mandate both operationally in terms of manpower and financially in terms of appropriate financial resources²⁰.
- 6.2 Further, it is important to safeguard compliance with the monetary financing prohibition pursuant to Article 123 of the Treaty. The prohibition is essentially designed to prevent central banks from providing overdraft facilities or any other type of credit facility to the public sector. National legislation should not require an NCB to finance the performance of tasks incumbent on the government, without stipulating that the government will compensate the NCB for the discharge of such tasks. The ECB notes that the draft law does not provide for such compensation and this

¹⁸ See the Specifications, p. 41: 'The national procedures should provide an important element, fostering accountability and transparency and defining the different tasks allocated to every actor in the forecasting exercise and the milestones to be met within the annual budgetary cycle. They should also set out practical steps leading to the production and/or endorsement of the forecast and principles of cooperation between the relevant institutional stakeholders'.

¹⁹ See Article 8 of the draft law.

²⁰ See the ECB's Convergence Report 2012, p. 26.

aspect would need to be addressed if the national legislature decides to keep the draft law as currently drafted on this particular point.

7. The requirements of independence under Common Principle 7

- 7.1 Pursuant to Article 3(2) of the TSCG, which refers to the independence of the institutions responsible at national level for monitoring compliance with the rules set out in Article 3(1) of the TSCG, and under Common Principle 7, ‘national legal provisions ensuring a high degree of functional autonomy shall underpin [the monitoring institutions], including: i) a statutory regime grounded in law; ii) freedom from interference, whereby the above bodies shall not take instructions, and shall be in a capacity to communicate publicly in a timely manner; iii) nomination procedures based on experience and competence; iv) adequacy of resources and appropriate access to information to carry out the given mandate’.
- 7.2 Central banks and their decision-making bodies are independent in exercising tasks and duties under the Treaty and the Statute of the ESCB, such as ESCB-related tasks²¹. The principle of central bank independence is, however, not automatically protected if a central bank is performing functions other than those laid down in the Treaty and the Statute of the ESCB. National law must provide for the independence of a central bank when the latter carries out non-ESCB-related tasks, if these tasks are required to be carried out by an independent institution.

Therefore, for functions laid down in the TSCG, a national legislator has to ensure compliance with Common Principle 7 and extend the statutory regime of independence to the relevant specific tasks if such tasks are allocated to an NCB.

This opinion will be published on the ECB’s website.

Done at Frankfurt am Main, 18 December 2013.

[signed]

The President of the ECB

Mario DRAGHI

²¹ See Article 130 of the Treaty and Article 7 of the Statute of the ESCB.