Working in the same or different directions?

Assessing the relationship between EU and domestic fiscal frameworks

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A two-level framework

• EU Member States retain control over most tax and spending matters

• “Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council” (Article 121 of the TFEU)

Independent fiscal institutions have proven their capacity to foster fiscal discipline and strengthen the credibility of Member States’ public finances. In order to enhance national ownership, the role of independent fiscal institutions, traditionally mandated to monitor compliance with the national framework, should be expanded to the economic governance framework of the Union.
A two-level framework: in theory

Both levels of oversight in the two-level framework are likely to be concerned with the same outcome variables, whether directly in terms of targeting identical measures or indirectly because compliance with one rule affects compliance with another.

• **Two-level framework should ideally be mutually reinforcing**
  o If the more binding of the requirements is pursued, the result is a more richly parameterized fiscal framework taking the two levels together
  o If either framework is subject to enforcement difficulties, a two-level framework may be more robust

• **But, risk of significant inconsistencies**
  • High-level differences in objectives
  • Intermediate rules could have different implications
A two-level framework: where inconsistency could arise

<table>
<thead>
<tr>
<th>Frameworks assess policy as</th>
<th>EU requirements</th>
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<tr>
<td><strong>National requirements</strong></td>
<td></td>
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<tr>
<td><em>Too loose</em></td>
<td>Agree on need to tighten</td>
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<tr>
<td><em>Appropriate</em></td>
<td>EU requiring tighter policy</td>
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- Risk of complexity
- Gaming the rules
How has this relationship played out since 2012?

• Data
  o New survey data collected from 30 EU IFIs, as part of the survey conducted by the Network of EU IFIs in Autumn 2022
  o Member IFIs were asked to rank their responses about the frequency of discrepancies in requirements/assessments between the EU/domestic level
  o Questions asked about frequency of material differences since 2012: “Often”, “Sometimes”, “Rarely”, “Never” or “Don’t know”
Many countries have EU obligations translated into national law (including Fiscal Compact). These may not precisely replicate EU rules.

- Almost 2/3 of Member States have other domestic fiscal rules that are independent of the EU framework.

Presence of independent domestic fiscal rules (i.e. different in nature than the EU framework)

- Yes: 18
- No: 10
- Don’t know: 2

Source: Network of EU IFIs (2023)
Almost half of surveyed IFIs report that domestic fiscal rules have been stricter than EU fiscal rules at least once.

- Countries where this occurs often see a tighter debt and structural balance rule.
- In some cases, structural balance rules were stricter than EU rules, but national expenditure rules were looser.

Source: Network of EU IFIs (2023)
Domestic v EU Frameworks

1/3 of Member States have at least one case where national framework stricter than EU framework

- National rules are stricter where applicable
- IFIs are generally more prudent in their assessment: many IFIs consider that EU thresholds and rules should be reached exactly as a limit rather than using margins of tolerance
- Output gap estimates, that underpin EU fiscal indicators, can be procyclical

Frequency of differing assessment of policy between IFIs domestically and the policy permitted under the EU rules

Source: Network of EU IFIs (2023)
1/2 of the Member States have experienced at least some contradictions
- 8 see discrepancies often
- Differences in output gap/structural balance assessments most common source of differences

Frequency of IFIs’ assessment differing materially from the Commission assessment

Source: Network of EU IFIs (2023)
Overall fiscal stance

- Most of the time, in most countries policies in the CSRs have been consistent with what national IFIs viewed as appropriate
- But, some exceptions in both directions

The CSR's fiscal stance as assessed by national IFIs

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- But, some exceptions in both directions

Source: Network of EU IFIs (2023)
Lessons from case studies – FIN, FRA, IRL

• These largely confirm the conclusions of the survey:
  o **FRA Budget Bill 2017** - HCFP more pessimistic than EC on forecasts, leading to different view of exit from corrective arm
  o **IRL 2015** – **failure to communicate** change in freezing assumption at EU level impacted assessment of compliance of adjustment requirement in preventive arm
  o **IRL 2015/2016** – **distorted potential output gap estimates** assessed by IFC to make expenditure benchmark inappropriate
Proposed reforms could reduce divergence

- *Ex ante* - There is potential for divergent EU and national assessments of the potential output, significantly affecting views of the required fiscal adjustment
  - Endorsement by IFIs of economic and budgetary forecasts
  - EU level taking into account opinions of IFIs may help

- *Ex post* - The simpler spending rule should *simplify compliance and monitoring*
  - Absence of one-offs
  - Legacy requirements at national level needs to be addressed
Conclusions

• The two-level fiscal surveillance in the EU may be reinforcing or may create tensions.

• EU and domestic fiscal frameworks have worked in harmony for most countries, most of the time.

• But, there were cases of material disagreement in the assessments of public finances between the EU and national levels.

• The main areas of disagreement were based on discrepancies in assessments of output gaps (OGs) and the structural balance, the size of discretionary revenue measures (DRMs) and one-off measures.

• These disagreements have generally seen national frameworks and IFIs taking a more prudent approach.

• National IFIs reported some cases where their assessment of significant deviation from the fiscal rules was contradicted by an assessment of compliance by the Commission, which undermined their credibility.

• The new framework should reduce the scope for contradiction, but risks remain.