BRIEFING

European Parliament

The Advisory European Fiscal Board

This note examines the main features and presents recent developments regarding the advisory European Fiscal Board. This body was established by the European Commission in October 2015, in the context of the implementation of an "integrated framework for sound fiscal policies", proposed in the Five Presidents' Report of June 2015. The Annex presents excerpts from the 2017 and 2018 Annual Reports.

The Decision by the European Commission

In June 2015, the Five Presidents' Report on Completing Europe's Economic and Monetary Union set up a roadmap towards a deep, genuine and fair Economic and Monetary Union.

One of the planned immediate initiatives was the creation of a new advisory European Fiscal Board (EFB), aimed at providing a **public** and **independent** assessment of the budgetary policies of the Member States and the fiscal stance of the Euro area.

On 21 October 2015, the European Commission presented a Commission Decision establishing the EFB, as part of the package of measures for a Deeper and Fairer Economic and Monetary Union.

The EFB in the Five Presidents' EMU-report

According to the Guiding Principles of the Five Presidents' report (Annex 3), the EFB should:

> Coordinate the network of national fiscal councils;

> Advise the Commission and provide an economic judgement on the appropriate fiscal stance at the Euro Area and national level, on the basis of the rules of the SGP;

> Issue opinions in connection with the assessment of Stability Programmes and Draft Budget Plans; and

> Provide an *ex post* evaluation on the implementation of the economic governance framework.

Tasks

The EFB is tasked to contribute - in an advisory capacity - to the exercise of the Commission's functions in the multilateral fiscal surveillance, performed according to Articles 121, 126 and 136 TFEU. The EFB is mandated by the Commission to carry out four main tasks (Article 2):

1) Providing to the **Commission** an **assessment of the implementation of the Union fiscal framework**, in particular through the evaluation of the horizontal consistency in the decisions taken and the cases of serious non-compliance with fiscal rules;

2) **Advising the Commission on the prospective fiscal stance appropriate for the Euro area**, and on the consistency between national fiscal stances and the advised fiscal stance of the Euro area;

3) **Cooperating with national fiscal councils**, facilitating the exchange of best practices;

4) Providing **ad-hoc advice**, upon a request of the President of the Commission.

ECONOMIC GOVERNANCE SUPPORT UNIT (EGOV)
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Composition and independence

The EFB is composed of **a Chair and four Members** (Article 3). They are appointed by the Commission on a proposal of the President, for a period of three years (renewable once), and selected on the basis of merit and experience in macroeconomics and budgetary policy-making. The Commission Decision reads "*in the performance of their tasks, the members of the Board shall act independently and shall neither seek nor take instructions from the Union's institutions or bodies, from any government of a Member State or from any other public or private body*".

The Members of the EFB are assisted by a Secretariat, administratively attached to the Commission' Secretariat-General and led by the Head of the Secretariat, appointed for three years, renewable once[1].

Following a call for expression of interest for the selection of the members of the EFB, the Commission appointed on 19 October 2016 the Chair and the four Members, chosen after consultation with the ECB, the Eurogroup Working Group and the national fiscal councils[2].

The EFB's Chair is ***Niels Thygesen***, from Denmark, Professor Emeritus of International Economics at the University of Copenhagen and previously member of the Delors Committee, which prepared the outline of the Economic and Monetary Union in Europe in 1988-89. The other members of the EFB are:

- ***Roel Beetsma*** *(The Netherlands)*, Professor at the University of Amsterdam.
- ***Massimo Bordignon*** *(Italy)*, Professor of Public Economics at the Catholic University of Milan.
- ***Sandrine Duchêne*** *(France)*, General Secretary of AXA France and previously Deputy Director-General of the French Treasury.
- ***Mateusz Szczurek*** *(Poland)*, Professor of public finance and international economics at Warsaw University, former Finance Minister of Poland.

[1] Following an amendment of the Commission Decision adopted by the College of Commissioners last February, the Head of Secretariat is appointed by the Commission, after having consulted the EFB Chair. In the original version of the Commission Decision, the function of Head of Secretariat was exercised by the Chief Economic Analyst of the Commission.

[2] According to the Five Presidents' Report (its Annex 3), the EFB should "conform to the same standard of independence" as the national fiscal councils established by Directive 2011/85/EU (Article 6.1b) and Regulation 473/2013 (Articles 2 and 5).

Transparency, accountability and related comments

According to the **Commission Decision** (Article 6), the EFB provides advice to the Commission and shall publish an **annual activity report,** with summaries of the advices and evaluations provided to the Commission.

In its resolution of 17 December 2015 on completing Europe's EMU, the **European Parliament** stressed that "*the European Fiscal Board, as the advisory board of the Commission, should be accountable to Parliament and that, in this context, its assessment should be public and transparent*".

In its July 2015 Bulletin (p. 28), the **European Central Bank** regretted that the EFB was not given the right to "*provide and publish assessments of the Commission's SGP-related decisions in real time*", nor the right to "*make submissions in the European Parliament and at the relevant Council/Eurogroup meetings*". In addition, the ECB underlined how the "comply-or-explain" principle foreseen in the Five Presidents' Report was not included in the Commission Decision. In its Bulletin of June 2016 (p. 84), the ECB stated that "*the EFB will not be equipped with policy tools to actively influence the setting of fiscal policies and ... Given the envisaged institutional set-up, it is unclear how effectively the European Fiscal Board will be able to carry out its role.*"

In its report of July 2016 on the Euro area, the **International Monetary Fund** stated (p.19) "*To enhance enforcement and monitoring, the EFB... should be made fully independent in assessing the aggregate fiscal stance and implementation of SGP fiscal rules. This could be achieved by separating the EFB from the European Commission which is in charge of enforcing the rules and by ensuring strong ties with national fiscal councils through the EU Network of Independent Fiscal Institutions (EUNIFI).*"

Recent reports published by the EFB

On 10 October 2018, the EFB published its second Annual report ("2018 Annual Report"). The report reviews the way the EU fiscal framework was implemented in 2017, highlighting positive and negative developments and scope for improvement. The EFB also recommeded ways to simply the SGP and its governance framework.

On 18 June 2018, the EFB published its assessment of the general orientation of fiscal policy in the euro area. The report concludes that the favourable economic outlook offers a prime opportunity to rebuild fiscal buffers. The EFB also recommended to upgrade the EU's fiscal framework and prepare for joint stabilisation for the euro area to complete the EMU.

On 15 November 2017, the EFB published its first Annual report. The report "*reviews the way the EU fiscal framework has been implemented, highlighting imperfections and scope for improvement. It provides a comprehensive and independent assessment of how the SGP has been applied in the recent past*". The Annex of this document presents some excerpts from the Annual Report.

On 20 June 2017, the EFB published its first report on "Assessment of the prospective fiscal stance appropriate for the euro area". It expressed the "*view that in 2018 a neutral fiscal stance is appropriate for the euro area as a whole and that such a stance could be implemented through differentiated national fiscal policies within the parameters of the Stability and Growth Pact (SGP)***.**

Presentation of the reports in the **competent committee of the European Parliament**:

- The 2017 Annual Report to the ECON Committee on 4 December 2017 in the ECON Committee ;

- The June 2017 report on the fiscal stance in an ECON Meeting on 11 July 2017,

The Chair of the EFB also participated in an open meeting with ECON Coordinators in December 2016. The EFB-Chair is expected to present its 2018 Annual Report on 5 November 2018 in the ECON Committee.

Some further recent reading on public finances in EMU

- The 2018 Stability and Convergence Programmes: An Overview and Implications for the Euro Area Fiscal Stance as published by the **European Commissin services** in September 2018. It provides an overview of the 2018 Stability and Convergence Programmes submitted by Member States. It takes a glance at budgetary developments in 2017 and sets out the fiscal plans over 2018-2021, both at country level and the euro area and European Union (EU) as a whole. It also presents an analysis of the recent and prospective fiscal stance in the euro area.
- The European Fiscal Monitor by the network of **EU Independent Fiscal Institutions** (IFIs) as published on July 2018. It contains contributions from 24 independent national fiscal monitoring bodies from the EU as well as an overview produced by the Network's Secretariat in collaboration with the Centre for Applied Macro-Finance at the University of York.
- Coordination and Surveillance of Budgetary Policies of Euro Area Member States during the Autumn Cycle by the **EGOV Unit of the European Parliament**. It gives a short overview of the main steps in the framework of euro area Member States' budgetary policy coordination and surveillance during the autumn cycle of the European Semester. This enhanced monitoring and surveillance of euro area Member States' budgetary policies is done in accordance with EU law. It aims to identify and correct at an early stage during the Semester cycle any risks of deviation from fiscal policy recommendations agreed by the Member States, ultimately by asking an updated draft budgetary plan.
- Implementation of the Stability and Growth Pact by the **EGOV Unit of the European Parliament**. It gives an overview of key tevelopments under the preventive and corrective arms of the Stability and Growth Pact on the basis of (1) the latest Council decisions and recommendations in the framework of the SGP: (2) the latest European Commission economic forecasts; and (3) the latest COM opinions on the Draft Budgetary Plans of euro area Member States. The document is regularly updated.
- Structural budget balances in EU Member States by the **EGOV Unit of the European Parliament.** It provides a short overview of the concept and application of the structural balance rule(s) in the EU. It will be regularly updated, in particular, the Annex that shows progress made (based on the latest Commission forecast) by Member States in reaching their structural budget commitments under the preventive arm of the SGP.
- Public finances in Euro Area Member States: Selected indicators by the **EGOV Unit of the European Parliament.** It presents selected indicators on public finance for the Euro Area Member States and the Euro Area as a whole for 2017 (estimates) and in 2018 (forecasts).
- The role of national fiscal bodies: State of play by the **EGOV Unit of the European Parliament.** It provides an overview of the role played by independent national fiscal bodies in the preparations of forthcoming budgets of EU Member States

Annex: Selected items from the EFB's Annual Reports

2018 Annual Report

The macro-economy of the euro area and the EU gained considerable momentum in 2017. Real GDP increased by 2.4 % in both areas, more than half a percentage point faster than anticipated in spring 2016 when Member States presented their updated stability and convergence programmes. The rate of unemployment fell to levels observed during previous cyclical peaks. At the **end of the 2017 EU fiscal surveillance cycle, 13 Member States were estimated to have achieved their medium-term budgetary objective** (MTO), more than twice as many compared to spring 2016 when the 2017 surveillance cycle started.

Although favourable, the bird's-eye view masks a number of important issues. First, the **improvement of fiscal positions in 2017 differed markedly across Member States**. Some took full advantage of better-than-expected economic conditions and even reduced expenditure levels compared to plans, while others used windfall gains to adjust government expenditure (net of one-off increases) upward. The first group included euro area countries where the fiscal position was comparatively sound, whereas the second group comprised countries where the fiscal position was weaker. If all euro area countries had implemented the expenditure levels presented in their 2016 stability programmes, the aggregate budget deficit would have narrowed to 0.7 % of GDP, rather than showing a deficit of close to 1 % of GDP.

Second, the fact that **windfalls were only partly used to improve fiscal positions is also due to the unreliable quality of potential GDP estimates, the linchpin of the EU surveillance toolbox**. On the back of statistical revisions of national accounts plus changes of the commonly agreed method for estimating potential output, in spring 2018 the level of 2017 euro area potential GDP was up by close to 2 % compared to spring 2016 — by the same amount as actual GDP. At unchanged expenditure levels, such a revision alone would have implied a correction of the structural budget balance of the euro area of close to 1 % of GDP. Such an improvement compared to initial projections inevitably entices governments. As a result, the pro-cyclical properties of the structural budget balance came to pass.

Third, the implementation of the Stability and Growth Pact (SGP) did not adapt to the much improved macroeconomic conditions. For countries with weaker fiscal positions, implementation largely followed the practice of previous years when the euro area and the EU economies showed signs of weakness. Some forbearance may have been justified in spring 2016 when the Commission and the Council issued guidance for 2017 and the balance of risks was still perceived to be tilted to the downside. However, **in the course of 2017 and then in spring 2018, the implementation of the rules continued to rely on elements of flexibility and judgement introduced to accommodate difficult economic times, while the economic conditions had improved markedly**. In sum, 2017 was a clear example of both the asymmetry of the EU fiscal rules and the notorious difficulty of getting the timing of discretion right.

Amid concerns of excessive complexity and lack of transparency, the Commission and the Council agreed on some innovations to the implementation of the SGP. However, **these initiatives did not achieve their stated objectives of simplifying the rules**, because: (i) they added new elements without resolving potential conflicts with existing provisions and methods; and (ii) they were coupled with initiatives going in the opposite direction bearing witness to the persisting tendency to find and codify new forms of flexibility. As a result, complexity and opacity have actually increased.

Simpler rules and procedures are necessary but will not be enough to ensure effectiveness. One of the main predicaments of the current EU fiscal framework is the increasingly blurred distinction between the analytical assessment underpinning the application of the rules and the final decision of the policy-makers. As long as concerns about the impartiality of the assessment are not addressed, any attempt to simplify the rules would be short-lived. The quest or drive towards refinements and codification would continue. **One way to enhance trust among Member States and between the Commission and the Council is to clearly separate the role of the assessor from that of the decision maker(s**). Since trust is the flipside of reputation, the governance of the SGP needs to be adapted, either by assigning the task of the assessment to an independent entity, or by endowing the assessor with the necessary independence.

In 2017 some **national independent fiscal institutions (**IFIs) helped promoting fiscal discipline and improving the quality of official forecasts. Others remained silent, partly because of practical, institutional and political constraints. Important conditions for an effective role of IFIs are that they have free access to all the relevant information, at both national and EU level, and that governments have to comply with or explain deviations from their advice.

2017 Annual Report

Assessment on the application of the SGP in 2016 (p.7)

Application of the full range of flexibility clauses and other contingency provisions of the SGP **revealed a degree of complexity that raised questions of transparency and equal treatment** in the Council. Discretion and judgement came to play an increasingly important role, raising the issue of who was to exercise them, and how. The actual assessment of compliance with the SGP rules also drew increasing attention because it involves two indicators, or two different methods which, although conceptually equivalent, in practice often support diverging conclusions in terms of compliance or non-compliance. Again, the role of judgement in a system originally designed to be rules-based came increasingly to the fore.

In procedural terms, several developments stood out.

1. Under the preventive arm of the SGP, the Commission's ex post assessment of a flexibility clause granted to Italy did not provide a firm conclusion as to whether or not the required structural reforms had been implemented.

2. There were inconsistencies, across both time and several countries, in the way the two indicators for assessing compliance were used.

3. Cases of early and late submissions of draft budgetary plans gave rise to discussions among Member States in the autumn of 2015. The period during which plans were to be presented was made clear in September 2016, as were the specific rules for caretaker governments.

4. In May 2016, the Commission put forward country-specific recommendations for Spain and Portugal which extended the deadline for correcting their excessive deficits, in conflict with the existing recommendations issued by the Council under Article 126 of the Treaty.

5. The Commission delayed its assessment of effective action under the corrective arm of the SGP for Spain and Portugal until July 2016, despite having proposed already in May to extend the deadline for correction.

6. Member States with an insufficient rate of debt reduction – Belgium, Italy and Finland - were not placed under the corrective arm of the SGP, thanks to a broad interpretation of the other relevant factors.

These points are significant but they need to be seen in the specific context of the 2016 surveillance cycle. As indicated above, 2016 was not a typical year in the history of the SGP. In one way or another, virtually all the limits implied by the rules turned into actual constraints putting a lot of pressure on Member States, the Commission and the Council. The margins of the rules-based system have been explored and it is actually noteworthy that the number of significant cases was fairly limited.

Suggestions related to reforming the SGP (p. 52)

- **Reduce the complexity of the SGP**, while introducing well defined escape clauses to be triggered and applied with the involvement of independent judgement. This would serve the triple aim of simplifying rules, safeguarding flexibility and enhancing transparency.
- Under the corrective arm of the SGP, allow for **updating EDP recommendations in the event of an unexpected improvement of economic conditions**. This would enhance the symmetry of rules and prevent a recurring practice to replace structural adjustments with budgetary windfalls.
- Under the preventive arm of the SGP, require Member States to compensate for past deviations from the adjustment path towards the **medium-term budgetary objective** (MTO). This would prevent Member States from systematically planning deviations within the allowed margins.
- **Broaden and simplify the use of macroeconomic conditionality** in the EU budget in order to strengthen the enforcement of the rules and safeguard the effectiveness of EU finances.
- **Introduce in the SGP a link to the Macroeconomic Imbalance Procedure** (MIP) by regulating the speed of adjustment towards the MTO in relation to Member States' macroeconomic imbalances. This would address the risks that imbalances may pose to fiscal sustainability.

The role of Independent Fiscal Institutions (IFIs) (p.33)

The IFIs vary significantly across the EU Member States in terms of their design, scope, and mandate. This heterogeneity is mainly determined by pre-existing institutional setups prevailing at the national level, including local traditions, historical experiences and country-specific policy challenges. Although national specificities are to be acknowledged in the setup of IFIs, there is also a need to ensure that they enjoy a basic degree of effectiveness and leverage vis-à-vis national governments.

The broad panorama of IFIs offers a unique opportunity to draw lessons of good practice, in line with the mandate of the European Fiscal Board. However, providing a full and comprehensive review of all EU IFIs is a daunting task that goes beyond the scope of this report. Rather, this section takes a selective approach. It first presents a portrait of two specific IFIs – the Irish and the Dutch - with the objective to identify elements of best practice.

Possible fiscal stabilisation tool for the euro area (p.6)

A centralised fiscal instrument would add stability to the euro area. (...) The two most prominent proposals for a centralised stabilisation capacity are (i) an investment protection scheme, to remedy the observed pro-cyclicality in public investments; (ii) a common unemployment reinsurance scheme, to give national budgets more breathing space during downturns, when the provision of unemployment benefits becomes significant.

While both proposals have pros and cons, the **EFB is of the view that the investment protection scheme would be easier to implement both technically and politically**.

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